SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 317

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER

vs

FRANCIS E. TOWER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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1 In the Tax Court of the United States

Docket entries

PROCEEDINGS

1943

Apr. 26—Petition received and filed. Taxpayer notified. Fee paid.

26—Copy of petition served on General Counsel.

26—Request for Circuit hearing in Grand Rapids filed by taxpayer. April 27, 1943 granted.

May 14—Answer filed by General Counsel.

17—Copy of answer served on taxpayer. (Grand Rapids, Mich.)

Sept. 22—Hearing set October 25, 1943 in Grand Rapids, Mich.

Oct. 12—Application for subpoena duces tecum to Hazel I. Tower filed by General Counsel. October 12, 1943 subpoena issued.

28—Hearing had before Judge Harron on the merits—submitted. Motion and amended answer and appearance of Oscar E. Waer filed at hearing. Motion to amend answer granted. Briefs due Dec. 13, 1943. Reply briefs Dec. 28, 1943.

Nov. 15—Transcript of hearing Oct. 28, 1943 filed.

Dec. 10—Motion for extension to Jan. 27, 1944 to file respondent's brief filed by General Counsel. Dec. 11, 1943 denied.

10—Reply to amended answer filed by taxpayer. Dec. 11, 1943 copy served.

13—Brief filed by taxpayer.

22—Motion to reconsider motion for extension to file brief filed by General Counsel.

22—Order extending time to Jan. 19, 1944 to file brief entered.

1944

Jan. 19—Brief filed by General Counsel. Served Jan. 20, 1944.

20—Copy of brief served on General Counsel.

31—Reply brief filed by taxpayer. Jan. 31, 1944 copy served.

2 Mar. 3—Findings of fact and opinion rendered, Harron, Judge,
Div. 13. Decision will be entered for the respondent. Mar. 3, 1944 copy served.

3—Decision entered. Harron, J., Div. 13.

1944

May 26—Petition for review by U. S. Circuit Court of Appeals, Sixth Circuit with assignments of error filed by taxpayer. Proof of service filed.

27—Notice of filing petition for review sent to J. P. Wenchel, filed.

29—Proof of service filed.

July 4—Praecipe filed by taxpayer.

7—Counter designation praecipe of portions of record, proceedings and evidence to be contained in report on review filed by General Counsel with notice of service by mail.

17—Proof of service of counter praecipe filed.

29—Statement of points filed by taxpayer.

Aug. 2—Certified copy of order, extending the time to Sept. 1, 1944 to prepare and transmit the record, from U. S. Circuit Court of Appeals, Sixth Circuit, filed.

31—Certified copy of order from Sixth Circuit re transmission of the original exhibits to this Court, ten days prior to date of oral arguments filed.

31—Statement of evidence with agreement filed.

31—Stipulation for designation of record filed.

Sept. 13—Certified copy of an order from Sixth Circuit granting extension to October 1, 1944 to prepare and transmit the record filed.

3 In the Tax Court of the United States

Petition

Filed April 26, 1943

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:Conf.) dated February 8, 1943, and as the basis for this proceeding alleges as follows:

1. The petitioner is an individual with residence at 104 South Franklin Street, Greenville, Michigan. The returns for the periods here involved were filed with the Collector of Internal Revenue for the District of Michigan.

2. The notice of deficiency (copy of which is attached hereto and marked Exhibit "A") is dated February 8, 1943.

3. The taxes in controversy are income taxes for the years ended July 31, 1940 and 1941, and the deficiency asserted amounts to $3,357.73.

4. The determination of tax set forth in said notice of deficiency is based upon the following error:

(a) Refusing to recognize petitioner's wife as a partner in R. J. Tower Iron Works, and taxing petitioner with his wife's share of the partnership income.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a)

(1) In the years ended July 31, 1940 and 1941, R. J. Tower Iron Works was a limited partnership under the laws of the State of Michigan. Petitioner and Harvey A. Amidon were general partners therein. Hazel I. Tower, petitioner's wife, was the limited partner in the firm.

(2) Respondent refused to recognize Hazel I. Tower as a partner in said partnership and the deficiency asserted results from his determination that the income of Hazel I. Tower from R. J. Tower Iron Works for the years ended July 31, 1940 and 1941, was taxable to petitioner.

4 Wherefore, the petitioner prays that this Court may hear this proceeding and determine that a partnership existed among petitioner, Harvey A. Amidon, and Hazel I. Tower, and that, accordingly, the income of Hazel I. Tower from said partnership was not taxable to petitioner.

(Signed) FRANK E. SEIDMAN,
Counsel for the Petitioner,
Peoples National Bank Bldg.,
Grand Rapids, Michigan.

[*Duly sworn to by Francis E. Tower; jurat omitted in printing.*]

5 *Exhibit A to petition*

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE.
Feb. 8, 1943.

Office of Internal Revenue Agent in Charge, Detroit Division, 1808 Penboscot Building, Detroit, Michigan.

IT: Conf.

MR. FRANCIS E. TOWER.
104 South Franklin Street, Greenville, Michigan.

SIR: You are advised that the determination of your income tax liability for the taxable year(s) End. July 31, 1940 & 1941 discloses a deficiency of $3,357.73 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Internal Revenue Agent in Charge, Detroit, Michigan, for the attention of IT: Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the
6 deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.

By (Signed) GEO. E. NEAL,
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of waiver.

hms.

STATEMENT

IT: Conf.

Mr. Francis T. Tower, 104 South Franklin Street, Greenville, Michigan

Tax Liability for Taxable Years Ended July 31, 1940 and 1941

INCOME TAX

Years	Liability	Assessed	Deficiency
1940	$981.10	$381.55	$599.55
1941	3,546.29	788.11	2,758.18
Total	4,527.39	1,169.66	3,357.73

In making the determination of your income tax liability, careful consideration has been given to the revenue agent's report dated December 17, 1942.

7 Year 1940

Adjustments to Net Income

Net income as disclosed by return		$8,550.46
Unallowable Deduction and Additional Income:		
(a) Partnership income	$6,661.16	
(b) Commission expense	300.00	
		6,961.16
Net income as adjusted		15,511.62

Explanation of Adjustments

(a) The share of partnership net income in amount of $6,661.16 reported by your wife, Hazel I. Tower, from R. J. Tower Iron Works, Greenville, is held taxable to you under sections 22 (a) and 182 of the Internal Revenue Code.

(b) Commission advanced to Mr. Fred J. Addison in connection with a proposed sale of realty, which was consummated in the following taxable year, are not deductible as ordinary and necessary expenses of the fiscal year 1940. See item (c) for 1941.

Year 1940

Computation of Tax

Net income adjusted		$15,511.62
Less:		
Personal exemption	$2,500.00	
Credit for dependents	400.00	
		2,900.00
Balance (Surtax net income)		12,611.62
Less: Earned income credit (10% of $3,074.38)		307.44
Net income subject to normal tax		12,304.18
Normal tax at 4% on $12,304.18		492.17
Surtax on $12,611.62 (Amount in excess of $4,000.00)		488.93
Total tax		981.10
Less: Income tax paid at the source		none
Corrected income tax liability		981.10
Income tax assessed: Original, Account No. Oct. 200067		381.55
Deficiency of income tax		599.55

Year 1941

Adjustments to Net Income

Net income as disclosed by return		$10,450.56
Unallowable Deductions and Additional Income:		
(a) Partnership income	$13,958.57	
(b) Rents	202.21	
(c) Expense of sale	476.30	
		14,637.08
Total		25,087.64
Nontaxable Income and Additional Deductions:		
(d) Long-term capital loss	57.84	
(e) Loss from sale	660.63	
		718.47
Net Income as adjusted		24,369.17

Explanation of Adjustments

(a) The share of partnership net income in amount of $13,958.57 reported by your wife from R. J. Tower Iron Works, Greenville,

is held taxable to you under sections 22 (a) and 182 of the Internal Revenue Code.

9 (b) Decrease in rental loss results from disallowance of excessive depreciation of two houses, summarized as follows:

Depreciation deducted:	
Baldwin Lake cottage	$125.00
South Street house	220.70
Total	345.70
Amount allowable ($66.14 and $77.35)	143.49
Unallowable deduction	202.21

(c), (d), and (e). Commission and legal fee in connection with sale of the Consolidated property are expenses of the sale, subject in part to the percentage limitation of section 117 of the Code. This applies also to commission disallowed in item (b) for the year 1940.

Losses (ordinary and capital) are increased by allowance of selling expenses referred to above. The amount of $660.63, allocable to the building, is allowable in full. The amount of $115.67, allocable to land, increases the long-term capital loss and is deductible at 50% in amount of $57.84.

(a) Computation of Alternative Tax

Net income as adjusted		$24,369.17
Plus: Net long-term loss		1,922.93
Ordinary net income		26,292.10
Less:		
Personal exemption	$2,000.00	
Credit for dependents	400.00	2,400.00
Balance (surtax net income)		23,892.10
10 Less: Earned income credit		644.24
Balance subject to normal tax		23,247.86
Normal tax at 4 percent on $23,247.86		929.91
Surtax on $23,892.10		2,870.87
Partial tax		3,800.78
Minus: 30% of $1,922.93, Net long-term loss		576.88
Alternative tax		3,223.90

(b) Computation of Tax

Net income as adjusted		$24,369.17
Less:		
Personal exemption	$2,000.00	
Credit for dependents	400.00	2,400.00
Balance (surtax net income)		21,969.17
Less: Earned income credit		644.24
Balance subject to normal tax		21,324.93

Normal tax at 4 percent on $21,324.93	$853.00
Surtax on $21,969.17	2,352.60
Total tax—Ordinary	3,205.60
Total Tax (Alternative tax in case of a net long-term loss)	3,225.90
Defense Tax (10% of Total Tax)	322.39
Total income and income defense taxes	3,546.29
Less: Income tax paid at source	none
Correct income and income defense tax liability	3,546.29
Income tax assessed: Original, Account No. 10-200076	788.11
Deficiency of income and income defense taxes	2,758.18

11 In the Tax Court of the United States

Answer

Filed May 14, 1943

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1, 2, and 3. Admits the allegations contained in paragraphs 1 to 3, inclusive, of the petition.

4. (a) Denies that the respondent, in determining the tax liability, committed error as alleged in subdivision (a) of paragraph 4 of the petition.

5. (a), (1), and (2) Denies the allegations contained in subsections (1) and (2) of subdivision (a) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore it is prayed that the taxpayer's appeal be denied.

(Signed) J. P. WENCHEL.
P. M. C.
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
DEWITT M. EVANS,
Division Counsel,
MELVIN S. HUFFAKER,
Special Attorney,
Bureau of Internal Revenue.

PMC/y 5/11/43.

671093—45——2

12 In the Tax Court of the United States

Respondent's motion to amend answer

Filed at Hearing, Grand Rapids, Oct. 28, 1943. Granted Oct. 28, 1943—(Signed) Marion J. Harron, Judge.

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and

Moves to amend his answer heretofore filed in this proceeding by adding thereto the following paragraphs:

7. If it be held that the share of partnership income from R. J. Tower Iron Works reported by his wife, Hazel I. Tower, for the years before the Tax Court in this proceeding is not taxable to petitioner under the provisions of Section 22 (a) of the Internal Revenue Code then respondent in the alternative alleges and avers that for said years R. J. Tower Iron Works was for Federal income tax purposes an association taxable as a corporation and that the distribution held to be attributable to his interest therein are taxable to him as ordinary dividends, and in support thereof states as follows:

(a) Title of the real estate and personal property formerly owned by the dissolved corporation of the same name were conveyed, assigned, and transferred by the dissolved corporation to the partnership;

(b) Full power to manage, operate, and thereby control the business, is centralized and vested in the general partners who are empowered to act essentially as directors of a corporation; by specific provision of the articles of partnership the general partners shall advise with each other in all things pertaining to any business policy, the purchase and sale of any business property, the making of business contracts, the borrowing of money, the signing of promissory notes and other evidences of indebtedness and if the majority of the general partners shall be unable to agree the decision shall be controlled by the majority in capital interest of the general partners;

(c) Continuity of existence without termination or interruption by death or change in the ownership of beneficial interest may be achieved under the articles of partnership;

13

(d) The interests of both the general partners and the limited partners may be sold and assigned in accordance with provisions made therefor in the articles of partnership;

(e) Each of the partners shall share in the profits of the business as his or her contribution to the partnership capital bears to the total partnership capital but a limited partner shall in no event be liable for or subject to any loss whatsoever in excess of her con-

tribution to the firm's capital funds as provided by the articles of partnership;

(f) The partnership as to name, business and ownership is a continuation of the predecessor corporation and the property of the firm was at formation identical with that of the predecessor corporation at the time of its dissolution.

Wherefore, respondent prays that this motion be granted and that his answer be amended in accordance therewith.

(Signed) J. P. WENCHEL,
P. M. C.
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
DEWITT M. EVANS,
Division Counsel,
MELVIN S. HUFFAKER,
Special Attorney,
Bureau of Internal Revenue.

MSH:daj:10/24/43.

14 In the Tax Court of the United States

Reply to Respondent's Amended Answer

Filed Dec. 10, 1943

Comes now the petitioner, by his attorney, Frank E. Seidman, and for reply to the respondent's amended answer, admits and denies as follows:

7 (a) Admits the allegations contained in paragraph 7 (a).

7 (b), (c), (d) Denies the allegations contained in paragraphs 7 (b), (c), (d).

7 (e) Denies that during the years in issue, each of the partners shared in the profits of the business in the same proportion as his or her contribution to the partnership capital bears to the total partnership capital, but admits that a limited partner is not liable for debts of the partnership in excess of his contribution to the partnership capital.

7 (f) Denies that the partnership, as to ownership, is a continuation of the predecessor corporation, but admits that the property of the partnership at formation was the same as that of the predecessor corporation at the date of its dissolution.

8. Denies generally and specifically each and every allegation contained in respondent's amended answer not heretofore specifically admitted, qualified, or denied.

Wherefore petitioner prays that respondent's plea for affirmative relief be denied.

FRANK E. SEIDMAN,
Counsel for Petitioner,
Peoples National Bank Bldg.,
Grand Rapids, Michigan.

15 In the Tax Court of the United States

Findings of fact and opinion

Promulgated March 3, 1944

Prior to August 30, 1937, petitioner owned all but a few shares of stock of a corporation which carried on a business of manufacturing sawmill machinery. Petitioner had been the real operator of the business for ten years. In August of 1937 he decided to dissolve the corporation and transfer the assets and business to a partnership. Five days prior to the dissolution of the corporation, and in anticipation thereof, petitioner transferred some of his stock in the corporation to his wife, and two days prior thereto a partnership agreement was executed under which the wife was to be a limited partner. Thereafter the corporation's assets were transferred to the partnership. The wife did not contribute any services to the business. The business was conducted by petitioner after the change-over to a partnership in the same way as before, except that petitioner was not paid a salary and part of the earnings were credited to a capital account in the wife's name. Held, (1) that there was no bona fide gift of stock to the wife, and that she did not contribute capital to the partnership; (2) that there was not a true partnership between petitioner and his wife for the conduct of a business, but a partnership for tax avoidance which can not be recognized.

Oscar E. Waer, Esq., and Frank E. Seidman, C. P. A., for the petitioner.

Melvin S. Huffaker, Esq., for the respondent.

Respondent determined deficiencies of $599.55 and $2,758.18 in petitioner's income tax returns for the respective fiscal years ended July 31, 1940, and July 31, 1941. Some of the adjustments are not in controversy here. The issue is whether the amounts of $6,661.16 and $13,958.57 which were credited in the taxable years to petitioner's wife as her distributive share of the net income of an alleged partnership are taxable to petitioner. In the alternative, respondent contends that the partnership was an association taxable as a corporation.

16 Petitioner resides in Greenville, Michigan, and filed his returns for the taxable years with the collector for the district of Michigan.

Findings of fact

The R. J. Tower Iron Works, located at Greenville, Michigan, is engaged in the manufacture and sale of sawmill machinery and wood and metal stampings. Petitioner has been actively engaged in the business for the past 28 years and since the death of his father, R. J. Tower, in November 1927, petitioner has assumed the responsibility of carrying on the management and operation of the business. In the taxable years the business had an average of 40 to 60 employees, gross assets of approximately $200,000, and an average steel inventory on hand of approximately $50,000. The sawmill machinery was marketed through dealers and the stampings were sold directly to manufacturers of refrigerators and stoves.

On September 9, 1933, the business was incorporated under the name of "The R. J. Tower Iron Works, Inc.," hereinafter referred to as the corporation. The outstanding capital stock consisted of 500 shares of a par value of $100 per share, of which petitioner received 425 shares, Harvey A. Amidon received 50 shares, and H. J. Lawrance received 25 shares. The bylaws required that the directors hold stock in the corporation and the 3 stockholders were the directors. Petitioner was president, and Amidon was secretary and treasurer. Approximately 6 months after the corporation was organized, in the early part of 1934, petitioner purchased Lawrance's 25 shares of stock and Lawrance severed his connections with the corporation. Immediately after purchasing Lawrance's stock, petitioner made a gift of 5 shares to his wife, Hazel I. Tower, who was made a director and vice president of the corporation. After the gift of 5 shares to his wife, petitioner owned 445 shares, and Amidon owned 50 shares. The ownership of the shares remained the same until August 1937.

17 A tentative operating statement as of July 31, 1937, showed that the business of the corporation had been successful and that substantial profits had been realized in the year 1937. In July 1937, after having discussed the matter with his wife, petitioner talked with Amidon with regard to the advisability of dissolving the corporation and setting up a partnership. Amidon kept the books of the corporation under petitioner's supervision, and he had worked in the business for a long time. Amidon had no objection to the formation of a partnership and believed that the change would not create any great risk as far as he was personally concerned. Consultations in this respect

were also held with petitioner's attorney and his accountant who took care of petitioner's tax matters. They were all of the opinion that the formation of a partnership would result in tax savings and alleviate the necessity of filing various corporate returns. It was decided that petitioner should transfer stock of the corporation to his wife so that she would be able to contribute a substantial share of the partnership capital.

On August 25, 1937, petitioner transferred to his wife 190 shares of the corporate stock owned by him. The transfer was conditional upon the wife's placing the corporate assets which the shares represented into the new partnership. The transfer was recorded on the corporate books and a new stock certificate was issued and delivered to petitioner's wife. Petitioner filed a gift tax return on March 15, 1938. He reported the 190 shares of stock transferred to his wife at a value of $57,114.60 and paid a gift tax of $213.44.

The corporation was completely liquidated on August 28, 1937, and it was dissolved on August 30, 1937. On August 28, 1937, petitioner, his wife, and Amidon executed a limited partnership agreement for the purpose of carrying on the business of the corporation, and all of the assets and liabilities of the corporation were transferred to the partnership.

The partnership agreement provided that the business would be carried on under the firm name of R. J. Tower Iron Works, for a period of 20 years, unless sooner terminated by a decision of a majority in interest of the partnership capital; that petitioner
18 and Amidon would be general partners and petitioner's wife would be a limited partner; that petitioner's contribution to the partnership capital was $81,600, his wife's was $62,400, and Amidon's was $16,000; and that the partners would share profits and losses in proportion to their respective contributions to capital, except that petitioner's wife was not liable for losses in excess of her capital contribution. The agreement further provided, among other things, that the general partners were to have the exclusive voice in the management and control of the business and were authorized to determine the salaries of the general partners; that if a majority of the general partners were unable to agree, a majority of the general partners in capital interest would control; that accounts of the partnership business would be rendered to the partners each year; and that the net profits for each year would be distributed at such times and in such manner as the general partners might determine.

A certificate of limited partnership was filed with the clerk of the Circuit Court of Montcalm County on August 31, 1937. Notification of the liquidation of the corporation and the formation of the partnership was given to those banks with which the corporation had transacted business.

Under the partnership agreement petitioner's share of the partnership profits and losses amounted to 51 percent; his wife's share amounted to 39 percent; and Amidon's share amounted to 10 percent. Amidon had formerly been employed by the corporation as a bookkeeper and he continued to perform similar work for the partnership. In the early part of 1938 his responsibilities and duties increased as a result of an increase in the volume of business. Petitioner and his wife were of the opinion that Amidon was entitled to a larger share in the profits and, accordingly, his share in the profits was increased from 10 percent to 25 percent on September 1, 1938. The shares of petitioner and his wife were proportionately decreased and thereafter petitioner received 42½ percent of the profits and petitioner's wife received
32½ percent. The redistribution of profits was orally
19 agreed upon between the parties, and the original agreement and the certificate of partnership on file with the county clerk were not formally amended. It was also orally agreed that petitioner and Amidon would not withdraw any future salary for their services. The original capital contributions of the parties remained the same.

Partnership accounts were maintained on an accrual basis for the fiscal year ending August 31. Capital accounts were opened on the books of the partnership, showing the amounts contributed by each party. Distributive shares of the profits of the parties were credited either to the capital account or to the drawing account of each individual party. The respective withdrawals of each party were charged to the drawing accounts. The share of profits and the aggregate net withdrawals of each of the parties for the fiscal years ended August 31, 1938, August 31, 1939, and August 31, 1940, were as follows:

	Share of profits credited to individual capital or drawing accounts			Withdrawals		
	Year ended 8-31-38	Year ended 8-31-39	Year ended 8-31-40	Year ended 8-31-38	Year ended 8-31-39	Year ended 8-31-40
Francis E. Tower	$2,658.28	$8,374.32	$17,947.26	$5,394.78	$10,458.38	$4,973.25
Harvey A. Amidon	521.23	4,926.06	10,557.21	938.96	4,410.18	5,183.08
Hazel I. Tower	2,032.80	6,403.88	13,724.38	4,311.66	2,032.80	5,000.60

The partnership return for the fiscal year ended August 31, 1938, reported a net income of $15,919.85. Of this amount $2,273.69 was petitioner's distributive share of income, and $7,761.20 was paid to petitioner in salary; $445.82 was Amidon's distributive share, and $3,700.44 was paid to Amidon in salary; and $1,738.70 was Hazel I. Tower's distributive share.

The partnership return for the fiscal year ended August 31, 1939, reported an ordinary net income of $20,495.87, of which $8,710.74 was petitioner's distributive share and was reported by petitioner in his individual return for the fiscal year ended July 31, 1940; $6,661.16 was Hazel I. Tower's distributive share and was reported in her individual return for the calendar year of 1939; and $5,123.97 was Amidon's distributive share.

20 The partnership return for the fiscal year ended August 31, 1940, showed an ordinary net income of $42,949.44, of which $18,253.51 was petitioner's distributive share and was reported by him in his individual return for the fiscal year ended July 31, 1941; $13,958.57 was Hazel I. Tower's distributive share and was reported in her individual return for the calendar year of 1940; and $10,737.36 was Amidon's distributive share.

Although Hazel I. Tower was vice president and a director of the corporation after the withdrawal of Lawrance, and attended the directors' and stockholders' meetings, she did not render any independent services to the corporation, nor was she actively interested or engaged in the business. In matters pertaining to the business she relied on her husband's judgment. The last return filed by the corporation, for the fiscal year ended August 31, 1937, reported compensation of $11,511.20 paid to petitioner for services rendered as president, and $5,450.44 paid to Amidon as secretary and treasurer. Petitioner's wife did not receive any salary from the corporation. She did not render any services to the partnership nor did she receive any salary.

Prior to the partnership agreement, petitioner gave his wife a regular allowance of approximately $75 a week for household expenses. After the formation of the partnership and throughout the taxable years petitioner continued to give his wife an allowance of $75 a week for household expenses and for her support, although she paid for some of her own clothes. Petitioner also paid the expenses of a daughter in college. Petitioner's wife had a savings account and a checking account, and she deposited some of the money that she withdrew from the partnership in these accounts and some of it in the form of cash in her box in a safe at home. Since the bank holiday in 1933 petitioner has kept all of his money and papers in this same safe, although he used a separate box. Both parties had the combination to the safe. During the year 1940 petitioner and his wife built and furnished a cottage at Baldwin Lake, petitioner contributing approximately $2,000 and his wife contributing $3,000. During that year
21 petitioner's wife also repaid petitioner the sum of $1,403.88, which represented expenditures made by petitioner for his wife's income tax and certain other expenses. They bought a

$100 war bond each month and each contributed one-half of the purchase price.

Petitioner performed the same services for the partnership as he had previously performed for the corporation. He did not receive any salary from the partnership after Amidon's share in the profits was increased on September 1, 1938. The partnership carried on the same business formerly carried on by the corporation and had the same customers.

The gift of 190 shares of the corporate stock of the R. J. Tower Iron Works, Inc., made by petitioner to his wife in 1937 was not valid and complete in that the wife did not gain full dominion and control over the shares. Petitioner's wife was not a bona fide partner in the business during the taxable years.

Opinion

HARRON, *Judge*: The only question for determination is whether petitioner is taxable upon his wife's distributive share of the net income of the R. J. Tower Iron Works, which was organized as a limited partnership under Michigan law. Under the partnership agreement, petitioner is a general partner and his wife is a limited partner.

Petitioner contends that his wife contributed 39 percent of the assets of the former corporation to the capital of the partnership and that she is a bona fide member of the partnership, entitled to receive a fixed share of its net income, based upon her capital contribution. He argues that the source of her capital contribution and the fact that she rendered no services to the partnership are immaterial to the determination of the question.

Respondent contends that the wife was not a bona fide member of the partnership, in that the partnership was not formed for any purpose other than minimizing petitioner's tax. He points out that the wife knew nothing of the business and contrib-
22 uted no services to the business. His argument is that, for Federal tax purposes, the gift of corporate stock by petition to his wife was unreal and a sham, and wholly ineffective to relieve petitioner from tax liability on the partnership income reported by the wife.

Petitioner concedes that his wife knew nothing of business matters and in that respect relied entirely upon him. He admits that she knew very little about the business of the R. J. Tower Iron Works and that she contributed no services to that company. He also admits that the change from the corporate structure to the partnership was made largely for tax purposes, and that his gift of corporate stock to his wife was made to determine her interest in the partnership.

It is well settled that transactions between husband and wife whereby tax is minimized are subject to rigid scrutiny, "for the temptation to escape the higher surtax brackets by an apportionment of income inside the family is a strong one." Champlin v. Commissioner, 71 Fed. (2d) 23, 26. Family arrangements resulting in the reallocation of income within the family unit should require clear and convincing evidence to support their bona fides, and the testimony of the participants in the transaction must clearly established that the particular transaction is genuine and made in good faith. Harry C. Fisher, 29 B. T. A. 1041; affd., 74 Fed. (2d) 1014.

A careful analysis of the testimony of this proceeding leads us to the conclusion that petitioner did not make a valid gift of the corporate stock to his wife in that he did not absolutely and irrevocably divest himself of the title, dominion, and control of the subject of the gift. The essential elements of a bona fide gift inter vivos are: (1) A donor competent to make the gift; (2) a donee capable of taking the gift; (3) a clear and unmistakable intention on the part of the donor to absolutely and irrevocably divest himself of the title, dominion, and control of the subject matter of the gift, in praesenti; (4) the irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee, so that the donor can exercise no further act of dominion or control over it; (5) a delivery by the donor to the donee of the subject of the gift or of the most effectual means of commanding the dominion of it; (6) acceptance of the gift by the donee; Edson v. Lucas, 40 Fed. (2d) 398, and authorities there cited. Cf. Allen-West Commission Co. v. Grumbles, 129 Fed. 287; Edwin J. Marshall, 19 B. T. A. 1260; affd., 57 Fed. (2d) 663; certiorari denied, 282 U. S. 61.

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In the light of the testimony of petitioner and his wife, the evidence indicates that petitioner did not intend making a gift of the stock; that he did not intend to divest himself of such title, dominion, and control of the stock as was necessary to constitute a good and valid gift thereof, *in praesenti;* and that the transfer was not such that the entire dominion and control of the gift was in the wife.

Petitioner testified that the subject of the gift to his wife was 190 shares of the corporate stock owned by him. He further testified that a certificate of this stock was delivered to his wife and that the transfer was noted on the stock record book of the corporation. He then testified that the reason for the gift was the "changeover" to the partnership and that the corporate assets were transferred directly from the corporation to the partnership. The testimony of petitioner's wife, on the other hand, was confused and at times contradictory. She first testified that the stock

of the corporation was given to her with the understanding that it was going to be put back in the partnership. She then testified that the subject of the gift was not stock in the corporation, but an interest in the partnership; that no stock certificate was delivered to her, but that her interest in the business was "just credited to me on the books." Subsequently, she testified that petitioner gave her a typewritten certificate for 190 shares of the corporate stock, and that she retained the certificate for three days until the partnership was formed, whereupon she returned it to her husband.

Under these circumstances, it is our opinion that the petitioner did not relinquish control of his stock nor did petitioner's wife gain control over any of it at any time. There was no unconditional gift of the stock to her, since she could only use it in one way, namely, to place the corporate assets which the stock
24 represented into the partnership. Petitioner never intended that his wife should have the 190 shares of stock to do with absolutely as she pleased. Upon the dissolution of the corporation, she was not free to sell or otherwise dispose of her share of the corporate assets. As a matter of fact, she never received her proportionate share of the assets, but they were all transferred directly to the partnership.

We think the principle underlying the decision in *F. Coit Johnson*, 33 B. T. A. 1003; affirmed in *Johnson* v. *Commissioner*, 86 Fed. (2d) 710, is applicable to the situation here. The question in that case related to the legal effect of a gift of a $400,000 bank check made by a taxpayer to his wife pursuant to a plan whereby the funds were made the corpus of a trust and immediately loaned to the husband upon his unsecured interest-bearing note. The taxpayer paid interest on the note and claimed a deduction from income for the same on his return. The Circuit Court of Appeals held that there was no bona fide gift by the taxpayer to his wife, and said:

"Counsel for the petitioner asserts that the transactions above described resulted in the following legal relations: Mr. Johnson made an absolute and unconditional gift of $400,000 to his wife; with her own property she set up a trust having a capital of $400,000; the trustee loaned this sum to Mr. Johnson upon his demand note bearing interest, and he paid such interest to the trustee in 1931. If such were indeed the legal relations of the parties, it would follow as of course that the taxpayer should be allowed the claimed deduction, for it is too well settled to require discussion that legal transactions cannot be upset merely because the parties have entered into them for the purpose of minimizing or avoiding taxes which might otherwise accrue. * * * Despite such purpose, the question is always whether the transaction

under scrutiny is in reality what it appears to be in form * * *

"P··· there is a fallacy in the petitioner's contention, and ··s in the premise that he made an absolute and unconditional
25 gift of $400,000 to his wife, and that her money set up the funded trust. There was an agreement between them that the money he made available to her was to be used in only one way; she was to pass it to the trustee upon terms which bound the trustee to return it to him upon request. Everything was done at the same time and as part of one transaction. Not for an instant did Mr. Johnson lose control of his 'gift,' nor did Mrs. Johnson or the trustee have possession of it free from a duty to return it to him. * * *"

See also Guaranty Trust Co. (N. Y.) et al., Executors, 35 B. T. A. 916; affd., 98 Fed. (2d) 62; J. L. McInerney, 29 B. T. A. 1; affd., 82 Fed. (2d) 665; Adolph Weil, 31 B. T. A. 899; affd., 82 Fed. (2d) 561; certiorari denied, 299 U. S. 552; Empire Trust Co. et al., Executors, 41 B. T. A. 839; affd., 119 Fed. (2d) 421; George H. Whiteley, Jr., 42 B. T. A. 402; affd., 120 Fed. (2d) 782; certiorari denied, 314 U. S. 657.

Here, the transfer of the corporate stock by petitioner to his wife was more fanciful than actual, since there was no purpose to transfer the stock to her apart from the agreed plan that the gift would determine her interest in the partnership. The gift, however, was not an absolute and unconditional one. Its purpose and intent was not to vest absolute dominion over the shares in the wife, since she had no untrammeled freedom in their disposition and they were not subject to her own control and desires.

In view of the fact that the gift of the corporate stock by petitioner to his wife was not valid and complete, it follows that she made no capital contribution to the partnership, and, since she admittedly rendered no services, it must be held that she was not a bona fide partner.

It should also be noted that the dissolution of the corporation and the subsequent formation of the partnership fulfilled no business purpose other than the savings of tax to petitioner. The change did not add any new capital to the business. As a matter of fact, the company was long established, in good financial condition, and did not need additional capital. Since the death
26 of petitioner's father in 1927, the business had been directed and managed solely by petitioner. In large measure, the success of the business was due to his personal efforts and ability. Under the corporate form of doing business, petitioner was president and general manager of the corporation and owned approximately 90 percent of the stock. Amidon kept the books of the company and worked under petitioner's supervision. After the partnership was formed petitioner and Amidon became general

partners, but petitioner still continued to control and actively direct the affairs of the company. Petitioner still owned 90 percent of the business. After the formation of the partnership, the business had the same capital, the same assets, the same liabilities, the same management, the same plant, the same customers, the same employees, and the same name. In Gregory v. Helvering, 293 U. S. 465, the Court disregarded a transfer of assets which was made without a business purpose and solely to reduce tax liability. In that case, the Court held that the Government may look at actualities, and, upon a determination that the form employed for doing business or carrying out the challenged tax event was unreal or a sham, it may disregard the effect of the fiction. In Higgins v. Smith, 308 U. S. 473, the Court reiterated the same rule, holding that, while a taxpayer was free to voluntarily choose any organization for the conduct of his business, the Government was not required to acquiesce in that election if in fact that method of doing business was unreal. In Helvering v. Clifford, 309 U. S. 331, the Court, in holding that a device to break up one economic unit into two or more would not be conclusive on the Government under the income tax law, said:

"* * * For where the head of the household has income in excess of normal needs, it may well make but little difference to him (except income-tax-wise) where portions of that income are routed—so long as it stays in the family group."

In Harrison v. Schaffner, 312 U. S. 579, the Court pointed out that taxation is a practical matter, dependent not upon "attenuated subleties," but rather upon practical considerations. It was held that one vested with the right to receive income did not escape the tax by any kind of anticipatory arrangement, however skillfully devised, by which he procures payment of it to another. In Helvering v. Horst, 311 U. S. 112, the Court said:

"* * * The dominate purpose of the revenue laws is the taxation of income to those who earn it or otherwise create the right to receive it. * * *"

At the time the partnership was first contemplated, petitioner discussed the arrangements with his wife before consulting Amidon. Petitioner testified that Amidon did not object to the contemplated partnership, since "he wasn't in position to object because I have done quite a little for Mr. Amidon." He also testified that Amidon knew he was not taking a great risk in entering the partnership. There can be little doubt that for all practical purposes, the business of the R. J. Tower Iron Works was petitioner's business both before and after the partnership was organized. After the first year of the partnership neither petitioner nor Amidon drew any salary from the business, although both devoted their full time and energy to the business. The sole compensation

of each was his distributive share of the net income. As a result of the arrangements, petitioner's wife received a full share of the partnership income even though she contributed neither time nor service to the business. This arrangement was unusual and unreal, especially in view of her limited liability.

The only record of withdrawals by the partners are for the fiscal years 1938, 1939, and 1940. During these years petitioner's wife withdrew substantial amounts from the partnership. During this period she maintained a savings account and a checking account, and the balance of the withdrawals was placed in cash in a safe maintained in her home to which petitioner had access. Respondent attempted to subpoena the records of the checking account, but was unable to do so because the wife testified that the checks were destroyed by her at the end of each year. However, the
28 record indicates that for the taxable year 1940 she withdrew $5,000 from the business. Of this amount, the sum of $1,403.88 was paid by the wife to petitioner for expenditures which he had made in paying his wife's income tax and various other expenses. During that year she expended $3,000 toward the purchase and furnishing of a summer cottage used by her family. Petitioner contributed approximately $2,000 toward this purchase. Petitioner and his wife also purchased war bonds monthly, each contributing 50 percent toward the purchase price. We think that these purchases toward which the wife made substantial contributions were those usually assumed by a husband for the welfare of his family, and that the withdrawals by the wife from partnership were merely for the reallocation of income within the family to be used for the benefit of the family.

In this proceeding, petitioner's wife made no actual contribution to the capital of the partnership, contributed no services, had no voice in the conduct of the business, and received a portion of the profits, not as a partner, but only by reason of her marital relationship. See Mead v. Commissioner, 131 Fed. (2d) 323, certiorari denied, 318 U. S. 777; Earp v. Jones, 131 Fed. (2d) 292; certiorari denied, 318 U. S. 764; Schroder v. Commissioner, 134 Fed. (2d) 346; Francis Doll, 2 T. C. 276. Under the facts it is held that there was no real partnership between petitioner and his wife for the conduct of a business enterprise and that petitioner was the person who earned the income which was credited to the wife's account. Therefore petitioner is taxable on the income attributed to the wife. Respondent's determination is sustained.

In view of the foregoing, it is unnecessary to consider respondent's alternative contention. Accordingly,

Decision will be entered for the respondent.

[SEAL]

29 In the Tax Court of the United States

Decision

Entered March 3, 1944

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated March 3, 1944, it is

Ordered and decided: That there are deficiencies in income tax for the fiscal years ended July 31, 1940 and July 31, 1941 in the respective amounts of $599.55 and $2,758.18.

(Signed) MARION J. HARRON, *Judge*.

In the Tax Court of the United States

Statement of evidence

Filed Aug. 31, 1944

Received Aug. 10, 1944

PROCEEDINGS BEFORE HONORABLE MARION J. HARRON, JUDGE

Oscar E. Waer and Frank E. Seidman appeared for the petitioner Francis E. Tower.

Melvin S. Huffaker, Esq., appeared for the Commissioner of Internal Revenue, Respondent.

On application of Mr. Huffaker a motion to amend respondent's answer was filed subject to the same objection as was made in the Canfield case, the petitioner making a general denial of each and every allegation of the amendment.

30 *Offers in evidence*

MR. WAER: If your Honor please, in order to avoid taking up unduly the time of the Court, we have had counsel for the commissioner check certain documents which will be referred to from time to time in the case. Part of these are copies and I will state as I go along whether they will remain in the case. I offer first petitioner's Exhibit I, copy of Articles of Incorporation of R. J. Tower, Incorporated, a corporation which preceded the company in instant case.

Mr. HUFFAKER. No objection.

The COURT. It will be received as petitioner's Exhibit I.

(The Articles of Incorporation referred to was marked "Petitioner's Exhibit No. I" for identification and was received in evidenee).

Mr. WAER. I offer as Petitioner's Exhibit No. 2 what purports to be a Certificate of Stocks covering 190 shares of the stock of the corporation known as the R. J. Tower Iron Works, issued in the name of Hazel I. Tower.

The COURT. How many shares of stock?

Mr. WAER. One hundred and ninety, Hazel I. Tower.

The COURT. It will be received as Exhibit No. 2.

Mr. HUFFAKER. No objection.

(The Certificate of Stocks referred to was marked "Petitioner's Exhibit No. 2" for identification and was received in evidence).

Mr. WAER. I offer in evidence as Exhibit No. 3 what purports to have been Gift Tax Returns for the year 1937 of Francis E. Tower.

Mr. HUFFAKER. No objection.

The COURT. It may be received as Exhibit No. 3.

(The Gift Tax Return referred to was marked "Petitioner's Exhibit No. 3" and was received in evidence).

Mr. WAER. I offer in evidence as Exhibit No. 4 Gift Tax Donee's return for the calendar year 1937 of Hazel I. Tower.

Mr. HUFFAKER. No objection.

The COURT. Received as Exhibit No. 4.

(The Gift Tax, Donee's Return referred to was marked "Petitioner's Exhibit No. 4" for identification and was received in evidence.)

31 Mr. WAER. I offer in evidence as Petitioner's Exhibit No. 5 a typewritten copy which has been checked by the Government, of Minutes of Meetings of R. J. Tower Iron Works, being the meeting of the dissolution, of the winding up of the company.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 5.

(The copy of Minutes of Meeting referred to was marked "Petitioner's Exhibit No. 5" for identification and was received in evidence.)

Mr. WAER. Exhibit No. 6, a photostatic copy.

The COURT. What is the date of the dissolution of the company?

Mr. WAER. The certificate was filed in the office, received September 1st, 1937, and filed as of November 3rd, 1937.

The COURT. 1937?

Mr. WAER. 1937. I offer in evidence Petitioner's Exhibit No. 7, a copy of a limited partnership certificate.

The COURT. Just a minute. That is received as Exhibit No. 6.

Mr. WAER. Certified Copy of Limited Partnership Certificate of R. J. Tower Iron Works, certified by the Clerk of the Court of Montcalm County, Michigan, and showing the filing in that office.

Mr. HUFFAKER. No objection.

The COURT. What is the date of that?

Mr. WAER. The date of the filing is August 31st, 1937.

The COURT. It will be received as Exhibit No. 7.

(The Certified Copy of Limited Partnership Certificate referred to was marked "Petitioner's Exhibit No. 7" for identification and was received in evidence.)

Mr. WAER. I also offer in evidence as Petitioner's Exhibit No. 8 a copy of the Limited Partnership Agreement, signed by the three partners, Francis E. Tower, Hazel I. Tower——

The COURT. What was that?

Mr. HUFFAKER. Agreement of Partnership as distinguished from the Certificate.

32 The COURT. It will be received as Petitioner's Exhibit No. 8.

(The agreement of Partnership referred to was marked "Petitioner's Exhibit No. 8" for identification and was received in evidence.)

Mr. WAER. I offer in evidence a Warranty Deed from R. J. Tower Iron Works, a corporation, to limited Partnership, dated August 28th, 1937.

Mr. HUFFAKER. No objection, your Honor.

Mr. WAER. And being recorded in the office of the Registrar of Deeds, Montcalm County, Michigan, on August 31st, 1937, in Liber 208, on Page 253.

The COURT. It will be received as Exhibit No. 9.

(The Warranty Deed referred to was marked "Petitioner's Exhibit No. 9" for identification and was received in evidence.)

Mr. WAER. I also offer in evidence as Exhibit No. 10, Articles of Incorporation, from R. J. Tower Corporation to the Partnership, which Bill of Sale is dated August 28th, 1937.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Petitioner's Exhibit No. 10.

(The Articles of Incorporation referred to was marked "Petitioner's Exhibit No. 10" for identification and was received in evidence.)

Mr. WAER. I also offer in evidence what purports to be a form of letter which was sent to the creditors of the R. J. Tower Iron Works about the time of the dissolution of the corporation.

Mr. HUFAKER. I object to that being offered or received for the reason that it is not a copy of any letter, the copy is a form and I object at this time to that as being immaterial for any purpose of this proceedings.

Mr. WAER. I will ask that that be marked for identification at this time.

The COURT. It may be marked for identification.

(The form of letter referred to was marked "Petitioner's Exhibit No. 11" for identification only.)

Mr. WAER. As Exhibit No. 12, I offer in evidence photo-
33 stat of the Individual Tax Return of Francis E. Tower for the fiscal year ending 1938.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 12.

(The photostat of Individual Tax Return referred to was marked as "Petitioner's Exhibit No. 12" for identification and was received in evidence.)

Mr. WAER. I offer a similar one for Francis E. Tower, which is an original, and counsel for the Government asks leave to substitute later a photostatic copy.

The COURT. It will be received as Exhibit No. 13.

Mr. HUFFAKER. No objection.

(The original document referred to was marked as "Petitioner's Exhibit No. 13" for identification and was received in evidence.)

Mr. WAER. I also offer in evidence Income Tax Return for the fiscal year 1940, a photostatic copy.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 14.

(The Income Tax Return for 1940 referred to was marked as "Petitioner's Exhibit No. 14" for identification and was received in evidence.)

Mr. WAER. I also offer in evidence Income Tax return of Francis E. Tower for the fiscal year ending July 31st, 1941.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 15.

(The Income Tax Return for 1941 referred to was marked "Petitioner's Exhibit No. 15" for identification and was received in evidence.)

Mr. WAER. I also offer Income Tax Return of Hazel I. Tower for the calendar year 1937.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 16.

(The Income Tax Return referred to was marked "Petitioner's Exhibit No. 16" for identification and was received in evidence.)

Mr. WAER. I also offer Income Tax Return for the year 1938.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 17.

(The Income Tax Return referred to was marked "Peti-
34 tioner's Exhibit No. 17" for identification and was received in evidence.)

Mr. WAER. Also Income Tax Return of Hazel I. Tower for the year 1939.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 18.

(The Income Tax Return referred to was marked "Petitioner's Exhibit No. 18" for identification and was received in evidence.)

Mr. WAER. Also Income Tax Return of Hazel I. Tower for the calendar year 1940.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 19.

Mr. WAER. I also offer in evidence Corporation's Income Tax Return for the year 1937, or the portion of that year during which the corporation was in existence, the R. J. Tower's final return.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 20.

(The Income Tax Return referred to was marked "Petitioner's Exhibit No. 20" for identification and was received in evidence.)

Mr. WAER. Also offer in evidence Partnership Return of R. J. Tower Iron Works for the calendar year beginning September 1937, and ending August 31st, 1938. This is a copy.

Mr. HUFFAKER. No objection.

Mr. WAER. It belongs to Mr. Seidman's file, we would like the privilege of filing a copy.

The COURT. It may be received as Exhibit No. 21, to be substituted by a photostatic copy.

(The Partnership Return referred to was marked "Petitioner's Exhibit No. 21" for identification and received in evidence.)

Mr. WAER. Also offer a Partnership Income Tax Return of R. J. Tower Iron Works for the fiscal year ending August 31st, 1939.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 22.

(The Partnership Income Tax Return referred to was
35 marked "Petitioner's Exhibit No. 22" for identification and was received in evidence.)

Mr. WAER. Also offer Partnership of R. J. Tower Iron Works for the fiscal year ending August 31st, 1940.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 23.

(The Partnership document referred to was marked "Petitioner's Exhibit No. 23" for identification and was received in evidence.)

Mr. WAER. Also offer in evidence the Thirty Day Letter of the Internal Revenue Department addressed to R. J. Tower and dated September 17th, 1942.

Mr. HUFFAKER. I object to this Exhibit, your Honor, for the same reason in the other cases, that there is no question of the figures involved. Your ruling on these other cases was that they were admitted.

The COURT. It will be received in evidence as Exhibit No. 24.

(The Thirty Day Letter referred to was marked "Petitioner's Exhibit No. 24" for identification and was received in evidence.)

Mr. WAER. I also offer in evidence what purports to be the Liquidation Entry of August 1937, which has been checked by the counsel for the Government.

Mr. HUFFAKER. No objection.

The COURT. It will be received as Exhibit No. 25.

(The Liquidation Entry referred to was marked "Petitioner's Exhibit No. 25" for identification and was received in evidence.)

Mr. WAER. I also offer in evidence Opening Entries of the R. J. Tower partnership of August 26th, 1937, which has been checked by counsel for the Government.

Mr. HUFFAKER. No objection.

The COURT. It will be received in evidence as Exhibit No. 26.

(The Opening Entries referred to were marked "Petitioner's Exhibit No. 26" for identification and received in evidence.)

Mr. WAER. Also offer in evidence the tabulation made from the stock records of the R. J. Tower Iron Works covering the is-
36 suance and their cancellation, and re-issuance, etc., of the various Certificates of Stock from the beginning of the corporation down to the termination in 1937, which has been checked by counsel for the Government.

Mr. HUFFAKER. No objection.

Mr. WAER. I might state that that Exhibit in effect constitutes the Stock Records and we received all evidence from the Stock Transfer Book.

The COURT. It will be received as Exhibit No. 27.

(The tabulation of Certificates of Stock referred to was marked "Petitioner's Exhibit No. 27" for identification and was received in evidence.)

Mr. WAER. I also offer tabulation which has been only partly checked by counsel for the Government, which tabulation purports to cover the shares of the partnership during the partnership year, and as to Capital and Drawing Accounts for the years covered by the partnership.

Mr. HUFFAKER. No objection to that, and I would like to state that if the Court does not advise me within the next fifteen days that there is a change to be made, that the Exhibit as it stands will reflect the true situation.

Mr. WAER. The second page has a reconciliation.

The COURT. Do I understand that you are making a check of that?

Mr. HUFFAKER. There have been two items that we have been unable to check.

The COURT. Received as Exhibit No. 28 subject to check within fifteen days. If there is no correction within fifteen days, the Ex-

hibit is received in its present terms. Now, yesterday, it came to my attention in one of the cases that we promised to have the fiscal year for business and the calendar year for individuals, and I am not certain in my own mind whether it is necessary to bring up to the December 31st date of the last taxable year the fact with respect to withdrawals and we discussed this quite a bit yesterday in the Hearing of the Sleigh case, but if it does not cause a great deal of work, I would suggest that you read into the records the withdrawals from July 31st, 1941, up to December 31st, 1941. But it does not have to be done at this moment.

37 Mr. WAER. We will get the figures, your Honor, and get it into the records.

The COURT. There may be very few withdrawals.

Mr. WAER. I may state for your Honor's benefit that there is a little confusion on dates because of the fact that Mr. Tower's are filed on the fiscal year basis, ending July 31st, the Partnership Returns have been filed on a fiscal year, ending August 31st, and Mrs. Tower's returns are filed on the calendar year basis. It is very difficult to carry the dates in mind.

The COURT. I am going to make a note now so I will be able to check back. Mr. Tower's return is filed on the fiscal year basis, July 31st. His returns for July 31st, 1940 and 1941 are involved in the present procedures. Then this Partnership Return was filed for the fiscal year ending August 31st, and Mrs. Tower's are filed for the calendar year.

Mr. WAER. May I point out that the August 31st, 1938 and 1940 Partnership Income is the particular income we are discussing. Those two years come in July, 1940, and July, 1941, on Mr. Tower's return.

The COURT. August 1st to July 31st?

Mr. WAER. August 1st, 1939, the year ending August 31st, 1939, and August 31st, 1940, the Partnership is involved.

FRANCIS E. TOWER, called as a witness in his own behalf, testified as follows:

Direct examination by Mr. WAER:

I live at Greenville, Michigan, and am engaged in the manufacturing business located at Greenville, Michigan. I am a general partner in a limited partnership of the R. J. Tower Iron Works. I have lived in Greenville all of my life, and my family is comprised of my wife and two children. I have been connected with the business which is now being conducted by the R. J. Tower Iron Works for 28 years, and prior to that I was connected

38 with it while my father was carrying it on. He died in

November 1927, and since then I have had the active management of the business either as a corporation or partnership.

Prior to 1933 the business was conducted as a partnership under an assumed name, and it was reincorporated in 1933. Exhibit I is a copy of the Articles of Incorporation, and when the corporation was organized there were three stockholders, viz, Harold J. Lawrence, with 25 shares; H. A. Amidon, with 50 shares, and I, with 425 shares. After about six months Lawrence withdrew, and I purchased his 25 shares. At that time five shares were issued to my wife and 20 shares to me. I bought the 25 shares from Lawrence and then they were reissued five to my wife and twenty to me. This was on February 24, 1934. We have searched but have been unable to find the certificate for the five shares. We never obtained a regular stock certificate book because there were so few stockholders, so we had certificates made out on the typewriter and kept track of the certificates in the back of our record book. The certificate for the five shares at the time it was issued was given to Mrs. Tower, and she never turned it back at the time of the dissolution. There was no change in stock ownership after Lawrence withdrew and up to the time the corporation was dissolved in 1937.

Q. Tell us what led up to the dissolution of the corporation in July or August of 1937 with reference to why you were going to dissolve it and what your plan was with reference to the carrying on of the business under a different legal entity?

A. In July, the latter part of July, the three stockholders had discussed the advisability of changing, of dissolving the corporation and setting up a partnership. There were several reasons why the discussion originally came up, one of them being the fact that I had been involved in quite a number of personal ventures, some of which were rather disastrous in outcome, and I felt that in forming a partnership it might be a good plan for me to turn, that is as a corporation, to turn over part of my stock in the corporation to my wife with a view of giving her a similar interest in
39 the partnership. In that way my personal creditors would not have an opportunity to disturb at least her interest in the partnership, and I had also in discussing with Mrs. Tower, we had our children in mind, they were growing up and we were looking to their future at that time. Also the fact that we had the report, a Capital Tax Report, Corporate Report, both State and Federal, at that time, at least seemed to be rather complicated, and we thought we probably could simplify the operation of the business to quite an extent by forming a partnership. Of course, we were also advised that there was a possibility that we would save on our Income Tax in future years.

Q. Did you consult anyone outside of your own organization, I mean yourself, Mr. Amidon, and Mrs. Tower, about the advisability of changing from the corporate form to a limited partnership?

A. We had that discussion among ourselves, we naturally wanted to have it done legally, so we took it up with our attorney, Mr. Oscar Waer, and also with Seidman & Seidman, our accountants.

Q. What discussion, if any, did you have with Mrs. Tower at the time of turning over a part of your interests in the corporation before its dissolution?

A. We had discussed the matter in a general discussion and that would be the proper way to do it, to turn over a set amount of stock so that her interest in the partnership would be represented by a like amount: this was agreeable to her.

The corporate life expired on August 31, 1937, and it was on August 25, 1937, that I made a gift of 190 shares of stock in the corporation to my wife. Exhibit 2 is a photostat copy of the stock certificate which was written out on a typewriter on the letterhead of R. J. Tower Iron Works, Inc., and which was issued to my wife and was turned over to her. Later, at the dissolution of the corporation, which occurred within a few days, the certificate was turned back to the corporation and kept with its records.

In connection with the gift to Mrs. Tower, I filed a gift tax return, Exhibit 3, and in that connection a donee's return, Exhibit 4, was also filed. A gift tax was paid on the return. The gift tax return shows 195 shares, which was in error because my gift was only 190 shares, but apparently Seidman & Seidman the accountants, in preparing the return, included, also the five shares which had been given to my wife in 1934.

After the transfer of five shares to my wife in 1934, she was made vice president and a director of the corporation, which relationship continued until its dissolution, and during those years between 1934 and 1937, she attended and participated in directors' and stockholders' meetings. The corporation paid a $5,000.00 dividend in 1936, which was distributed among the stockholders, with Mrs. Tower receiving 10% on her stock holdings, viz. $50.00, Mr. Amidon receiving $500.00, and I receiving $4,450.00.

Exhibit 6, which is a photostat copy of the certificate of dissolution of R. J. Tower Iron Works, contains signatures which I recognize, and it is my recollection that the original of this document was filed with the Michigan Corporation and Securities Commission. In connection with the dissolution of the corporation, we held certain corporate meetings, adopted certain resolu-

tions, and took certain action which is in our record book and is covered by Exhibit 5.

In connection with the winding up of the corporation we filed an income tax return covering the business of the corporation up to the time of its dissolution, and the tax was paid on that return. The partnership was organized August 28, 1937. The Articles of Partnership, and the Partnership Agreement, being drawn up by our attorney and filed with the County Clerk at Stanton, the county seat. All of the assets of the corporation were turned in to the partnership; at the time we had no creditors except those represented by current bills.

Our plant is located in Greenville. We have in the neighborhood of from forty to sixty employees, depending upon the time of the year, and manufacture two principal items, one, sawmill machinery, a product made by our plant for 67 years, and the other, manufactured during the last ten years, in the nature of stampings made for the refrigerator trade—metal stampings. During 1940 and 1941 our gross assets were in the neighborhood of $200,000.00; and our inventory of steel would average about $50,000.00.

41 We have about 30,000 square feet of floor space, and sell our sawmill products through dealers, whereas our metal stampings are sold directly to the manufacturers of refrigerators and stoves. At certain times of the year, including 1938 to 1941, we had to borrow large sums of money from the Greenville banks.

Under the agreement of copartnership Amidon's interest was 10%, Mrs. Tower's interest 39% and my interest 51%. There was a change in that interest later because shortly after we formed the partnership in 1937, we took on a line of stampings and became very busy, so that our work increased rapidly and Mr. Amidon had to take on increased responsibilities. We were working both night and day at the time and we felt that he was entitled to more income for his efforts, or a better share of the profits that he had received, so we increased his profits from 10% to 25% and reduced Mrs. Tower's to 32½% and mine to 42½%, and since that time the profits have been divided in that proportion. I think this change was about the beginning of 1938. Nothing was filed in the County Clerk's office in the way of a formal agreement covering this change, it was simply a verbal agreement among three partners.

At the time I made the gift to Mrs. Tower of 190 shares there was no agreement between her and we covering the return by her of that stock certificate at any time. She wasn't asked, and never gave me, a general power of attorney authorizing me to transfer the stock to anyone. I have never had authority to make withdrawals on any bank account she may have had.

The partnership maintains its deposits in the First National Bank of Greenville and the Savings Bank of Greenville. I have had no personal checking account nor savings account myself in any bank since 1931. Mrs. Tower has a savings account and also a checking account in the First State Bank of Greenville, but I have had no authority to draw checks by signature or countersignature on any of these accounts. In connection with income tax returns, Exhibits 12, 13, 14, and 15, I may say that the taxes were paid, the partnership returns were prepared by the accountants, viz. Exhibits 16, 17, and 18, and a final return for the corpo-
42 ration was filed in 1937, viz. Exhibit 20. The tax was paid in connection with that return. The Seidman firm prepared my individual and also our partnership returns from time to time since 1937, and Mrs. Tower's returns were prepared by them. I know that the taxes were paid on all of her returns. It is my recollection that my own returns for 1938 and 1939 were not questioned.

Exhibit 28 covers withdrawals, the position of the capital account and drawing accounts of the respective partners. After the organization of the partnership capital accounts were set up for each individual partner, such accounts being set up on the basis of the partner's previous holdings in the corporation. Each partner was also given a drawing account to which the proceeds of the company could be charged or credited, as drawn. Exhibit 28 which purports to be the opening journal entry of the partnership, shows, a total capital account of $160,000.00.

The COURT. I wonder what was the increase in the capital account of the three partners in 1939; what is their interest? The capital account is the same for each one? In 1938 and 1940, but in 1939 there was a slight increase, then it goes back to the 1940 figure.

Mr. WAER. If your Honor please, unless Mr. Tower can answer it, I think Mr. Seidman could verify it.

The COURT. Well, it is unimportant, but in writing the Finding of Fact, if that difference is only in adjustment and doesn't mean anything, then I would be correct in saying in the Findings of Fact at least, that the capital of each partner in the account was just a fixed amount.

Mr. SEIDMAN. You would be correct in making that conclusion. The difference is a minor item. Through mechanical processes, there were some errors.

The COURT. Can it be agreed at this time between counsel that we found as a fact that the capital interest of each one of these partners is as follows: Francis E. Tower, $75,765.66, H. M. Amidon, $14,784.25; and Hazel I. Tower, $57,077.64.

Mr. HUFFAKER. Your Honor, on the previous Exhibit, my understanding was not that those figures you read, it was not my understanding of what the capital account was. The capital accounts, as I understand it, were round figures and were set
43 out at the top of Exhibit 26, and as I understand that, these figures you read off reflect some sort of an adjustment, I don't know just what the adjustments are.

The COURT. This gives me a problem of interpreting two exhibits and I don't want to do that. If the facts were stipulated, it wouldn't be necessary for me to make any interpretation of the exhibits.

Mr. SEIDMAN. Your Honor, the correct opening capital of each of the purchasers as of August 28, 1937, was, Frank E. Tower, $81,600.00, Mr. Amidon, $16,000, and Hazel I. Tower, $62,400, and that amount of capital was reflected by the books again on August 31, 1941, which is not in these records. In the interim there was charged to these capital and drawing accounts undistributed profits. It was then restored by correction to bring the amount up to the original capital as shown by Exhibit 26, therefore the $160,000 is the correct amount of capital.

Mr. HUFFAKER. The books will show that those were the entries made to the capital accounts by each individual.

Mr. SEIDMAN. That is correct.

Mr. HUFFAKER. The three that I am referring to are those set out at the top of Exhibit 26—$160,000.

(Witness continuing:)

The change in the division of profits made in 1938 had nothing to do with a change in the capital accounts of the partners. The change was merely a change of their share of the profits. Amidon's being increased from 10 to 25%; Mrs. Tower's reduced from 39 to 32½%, and mine from 51 to 42½%.

The COURT. Now, that leads to another question. During the taxable years involved, were the accounts of the three partners credited with profit according to these adjusted percentages last read in the record?

Mr. SEIDMAN. That is true. You are speaking of the years 1939 and '40; is that right?

The COURT. We are talking of the taxable years.

Mr. SEIDMAN. It wouldn't make any difference.

The COURT. We have those taxable years of 1940 and 1941.

Mr. HUFFAKER. The years ending July.

44 The COURT. That means years that end in the middle of those calendar years, the fiscal year ends in '41, so that carries back to '40 and the 1940 fiscal year carries back to 1939? In that connection, I have a question I want to ask at this time. Exhibit 28, schedule giving the share of profit of the individual draw-

ing account, covers three fiscal years, the last one ending August 31, 1940. Now, shouldn't you have another year August 31, 1941?

Mr. SEIDMAN. No; that comes after the close of the taxpayer's fiscal year, 1941, and therefore the fiscal year of the partnership of 1941 would come after the close of business. His return in 1941 is for the year 1940.

The COURT. Well, there evidently is something complicated there that I haven't comprehended. I am sorry to be slow on this.

Mr. WAER. That is the difficulty on these three different units.

The COURT. Our taxpayer is Francis E. Tower, Francis E. Tower, is our Petitioner, and he filed his return on the fiscal year basis ending July 31, so he had a fiscal year that ends on July 31, 1941, it must have been. There is a deficiency of $2,080.81. Now he could report the return of the partnership for the period of the fiscal year?

Mr. SEIDMAN. That is right; which would include for the year ending July 31, 1940.

The COURT. It would include earnings in 1941, though?

Mr. SEIDMAN. No.

The COURT. Why not?

Mr. SEIDMAN. For the earnings for the year 1941 he would include the income for the year which closed prior to the time the year closed.

The COURT. There is always a year a year long.

Mr. SEIDMAN. Yes.

The COURT. In other words, he does not break down the partnership income that comes to him in order to actually report income for his fiscal year.

Mr. SEIDMAN. That is correct.

The COURT. That is permitted?

Mr. SEIDMAN. The law requires that the individual
45 stays in the taxable year with distributive share of any interest or profit for the taxable year closing within the individual taxable year.

The COURT. Then for the partnership, the year is August 31, 1940 to August 31, 1941?

Mr. SEIDMAN. No.

The COURT. My point is this, that the fiscal year of the partnership does not come within his fiscal year.

Mr. SEIDMAN. That is right.

The COURT. And, therefore, he would go all the way back to the period September 1, 1939, which ends August 31, 1940, and August 31, 1940 is within the fiscal year, and his fiscal year begins August 31? That certainly is something I never have been aware of before, that is very interesting, 30 days gets them under the

line. I am glad I found that out now. Now, I think that clears up Exhibit 28 about the division of profits, so I have no other questions.

Mr. SEIDMAN. Might I volunteer Exhibit 28? There is one year shown on the top part of the exhibit, the year ending August 31, 1938. That is not before the Court at the present time, but is simply put in this to give the complete history.

(Witness continuing:)

In connection with our change from a corporation to a limited partnership, I went personally to both banks at Greenville from which we were borrowing money, and told them of our intended change. At the time we changed the percentages of profit, it was part of the agreement that we were to discontinue the payment of salaries to the general partners, and thereafter the partners took their percentage of profits without salaries. The new arrangement was effective beginning August 31, 1938, and the information return filed by the partnership for the fiscal year ended August 31, 1939, would be the first return which would reflect the change and in that year the books of the company would show no salaries paid to Messrs. Amidon and Tower. During the first fiscal year of the partnership salaries were paid—$7,500.00 to me and $3,500.00 to Mr. Amidon.

46 At the time of the gift in August of 1937 of the 190 shares to Mrs. Tower, I had been paying the expenses of running the home, and living expenses, and no change occurred in that respect in August of 1937 or since. As I have said, I have kept no personal checking or savings account since 1932, but we have a heavy steel safe in our home where I keep valuable papers, and a considerable amount of cash. We have had the safe about 25 years and it is since the bank holiday that I have kept large sums of money on hand.

The COURT. May I ask you one question before we take a recess? As I understand it, the capital account remains fixed; is that true?

Mr. WAER. Yes, your Honor; the arrangement made in 1937 covering the division of profits did not, as I understand it, did not effect in any way their capital interest in any way. If the partnership were liquidated, they were each to receive their original amount.

The COURT. That isn't what I mean. The partnership started with a capital of $160,000, now, each year one of these partners left in the business a certain part of the net earnings, so that there is an accumulation of earnings from year to year that are not withdrawn. Now, is it the practice, Mr. Seidman, to just have those accumulate in their personal drawing accounts, so that at the end of each year the balance, of course, increases, or do you at the

end of the year close out the personal drawing accounts and transfer the capital accounts?

Mr. SEIDMAN. The answer is both. There are two different systems. I will explain it.

The COURT. I would be more interested in knowing what was done in the fiscal year that comes within the taxable year, so if I want to make a Finding of Fact, I don't have to go outside of that. You know what the fiscal years are of the partnership coming within the fiscal year of the taxable year.

Mr. SEIDMAN. During the year ending August 1939, which is the first fiscal year of materiality in this case, the drawings and profit, distributive shares up to that point, and for that reason the August 31, 1939 balance, shown on Exhibit 28, is less than the opening capital. As, for example, on Francis E. Tower.

47 He started out with $81.600 as shown by Exhibit 26, but when you come to Exhibit 28 and look at the balance and all these balances are credited balances, a balance of $76.404, which means that he drew more up to that time than the distributive share credited to his capital. Now, thereafter, and before, this was for the year ending August 31, 1939, when this took place, the year ending August 31, 1940, the entries were made through a drawing account, and the drawing account was credited with a distributive share of the profit, as shown on the top of Exhibit 28 in the first schedule, the drawing account was charged with withdrawals during that period. So, this drawing account showed a credit balance at the end of that period as shown on Exhibit 28.

The COURT. And the capital account shows Francis Tower a balance of $75,971.65. I would assume that that balance in the capital account is going to be maintained.

Mr. SEIDMAN. No, that balance in the capital was then restored at the end of 1940, $71,996. On that account of Mr. Tower in the exhibit, you will notice in his opening entry, it was $81,600.

The COURT. Where did they get the money?

Mr. SEIDMAN. It was transferred at a later date from their——

The COURT. They transferred the difference between $81,600 and $7,500.

Mr. SEIDMAN. That is correct.

The COURT. Then the capital account still stayed $81,000?

Mr. SEIDMAN. That is correct, the same original capital stayed thereafter.

The COURT. Then, I think we can take a recess for a few minutes before the cross-examination.

Cross-examination by Mr. HUFFAKER:

The certificate for the five shares has been misplaced or lost, but during the period of the corporate life dividends were paid to

Mrs. Tower on that lost certificate. We did not know it was lost until the corporation was dissolved. This certificate was
48 given to my wife at the time I bought Lawrence out, which was about six months after the corporation was formed in 1933. Mrs. Tower became a director as soon as she received the five qualifying shares.

Q. Now, when did you first have discussions with respect to changing this corporation into another arrangement?

A. That is rather hard to say, the exact time that I know of, our pertinent discussion, which brought about the dissolution of the corporation was held some time the latter part of July, and we had several discussions after that.

Q. July?

A. 1937, that is right.

Q. Who was present at the discussions?

A. I would say that Mrs. Tower and I have talked about the thing before we had brought up the discussion with Mr. Amidon. We talked with each other about it particularly in view of the fact that we were thinking of our children and the fact that there might be a possibility to protect her, so if I became jammed up as I have in previous years, she would have something over and above my personal creditors' interest and afterwards, we took it up, we called Mr. Amidon in there and discussed it with him to see how he felt about it, and, of course, he had to assume certain responsibilities when we became a partnership.

Q. About what time of year did you first speak to Mr. Amidon?

A. The latter part of July, and then we brought all three of us into the discussion.

Q. Was this first discussion with Mr. Amidon held at your office?

A. I can't be sure as to that because we discussed it in those places.

Q. What was his first reaction to the suggestion?

A. Well, I go back into that, Mr. Amidon was in a position where he probably developed it, and he wanted to do whatever we wanted to do. However, we were careful to point out that
49 he would be accountable the same as the other partners, and we didn't want him to go into it without his eyes being open.

Q. Do you know what Mr. Amidon was worth at that time?

A. He owned his home, I would say the home is worth around $4,000 or $5,000. I would say his total worth would be in the neighborhood of somewhere around $5,000. He had some life insurance, too, I think, at that time.

Q. Did you take up the matter of taxes with Mr. Amidon?

A. I am not sure, I understand the question.

Q. Did you tak up the question of tax savings with Mr. Amidon?

A. Income tax savings?

Q. Yes.

A. When we had the discussion with the three of us, we have felt that we would save on the corporate taxes, you know we have the state and federal corporate taxes and the capital stock to pay, at least, we thought it was at that time, but when we got in touch with our attorneys, they thought there would probably be some saving in future years.

Q. Did you have in mind anything about how it might effect your estate?

A. No; that wasn't discussed at all.

Q. But you were of the opinion definitely, that there would be an income tax saving?

A. I had talked with Mr. Waer, our attorney, and Seidman and Seidman. It was thought at that time that there would be a tax saving under the partnership, as against the corporation, because in a corporation we paid taxes twice, we paid corporate taxes and income taxes, or a corporate taxes and as individuals we paid income tax.

Q. Was it your understanding that there would be substantial savings?

A. That would depend on our business, the amount of our savings would depend on the amount of our income.

Q. What I am trying to find out is whether you seriously did give consideration to the tax advantages, and it was possible that the savings would be very substantial?

A. That is a rather hard thing to qualify. We knew
50 that there would be, at the time of the discussion, that there would be a saving under the partnership as compared with the corporation.

Q. Now, with respect to the business at the end of the corporate term and the beginning of the new arrangement, were your duties carried over into making the new business the same as you did in the old?

A. That is right, there was no particular change in my duties.

Q. And did you read the Articles of Partnership before you signed the instrument?

A. That is right.

Q. Did you understand the provisions of the instrument?

A. I think so.

Q. And would you say that you have carried on your operations within the terms of that agreement?

A. That is true; I think so.

At the end of the first fiscal year a different percentage for distribution of profits was agreed upon verbally but nothing was

put in writing. The reason for it was because our business had grown and our sales had increased materially. We had gone into the stamping business which called for a lot of detail work. Prior to that time Mr. Amidon's duties had been almost entirely bookkeeping, but at that time we brought in a girl so that Amidon could go out in the factory and take over part of the executive work, some of the detail work in the factory. We were both compelled that year and the next year to work late at night, night after night, and my wife and I agreed that Amidon should be entitled to more share in the profits because he was putting in more efforts. His capital contribution was not changed, and no addition was made to the Articles of Partnership. Article V of the Partnership Agreement reads "Each partner shall share in the profits as his contribution to the partnership capital bears to the total partnership capital."

Q. Now, at the time you made this gift to your wife, do you recall where you were?

A. No; I don't exactly so far as the actual gift was concerned, I don't know whether that stock was given to
51 her at the office or at the house, I don't know exactly.

Q. Do you remember the time of year?

A. I think the stock was given to her in August, prior to our closing year.

Q. That was just a few days before the new arrangement was to be made.

A. I think I testified the 25th, that may not be the right date.

Q. Would you say about the 25th was about the time you first suggested this to your wife?

A. The first time we suggested the dissolution of the corporation do you mean?

Q. The first time that you suggested to your wife that you were going to make her a gift of stock was about the 25th of August?

A. I can't say exactly as to that because the only purpose, as I recall now, in giving her a definite amount of stock, so when the partnership was formed, that would determine her interest in the partnership, that was the basis of the gift.

Q. It was solely for this changeover that you made the gift?

A. That is right.

Q. What effect, you said you took into consideration the children growing up and looking to their future, how did that come into the consideration of this matter?

A. Indirect consideration but still we, naturally, think of our children and their education and security, and that was the way I had it in mind, that it would be possible, in other words, my plan was that I was worried about my contacts to get into trouble on one venture, or another.

Q. My question was, I don't think you understood it, how would the partnership help you assist your family more than some other form of doing business?

A. Well, I don't know as it would only under the partnership, if she was made a limited partner, that was part of the discussion, she would not be liable under my manipulations, should they turn out disastrous.

Q. And you thought that would indirectly help the children?

A. Indirectly.

52 Q. In other words, you didn't have any definite views on it?

A. No.

Q. Now, the business of the company, I believe you stated, is making metal stampings and sawmill machinery?

A. That is right.

Q. That was the business of the corporation?

A. Well, the business of the corporation had been largely of sawmill machinery because it was along towards the—we had a couple of years of the stamping business in the corporation.

Q. By metal stampings, did you deal largely in refrigerator legs?

A. That is one of the important items, although we made stove parts.

Q. And that was done by the corporation?

A. That is right.

Q. And that same business was done by the partnership?

A. I should qualify that, the business of the corporation had been about 99% of the manufacture of refrigerator legs and from the time—about the time we dissolved the corporation, we got into larger standards and put in larger equipment to make such things as refrigerator doors and complete bases for refrigerators that called for heavier equipment, and that is the only difference between the two.

Q. But prior to the time the corporation was dissolved, the corporation had made some fairly large expenditures in getting equipment to make these metal stampings?

A. We had quite an investment in the equipment but after the partnership was formed, we increased that heavily, putting in other equipment.

Q. But the corporation did have a substantial investment in that type of business?

A. That is right.

Q. Now, in the corporation, you were the president?

A. That is right.

Q. And you were the general manager of the corporation?

A. That is right, I never signed my signature as general
53 manager, I signed it as president, but I was working as general manager that is true.

Q. Well, was what might be called a closed corporation, you owned most of the stock, did you not?

A. You mean at the time of the dissolution?

Q. At the time of the dissolution.

A. I owned 51%.

Q. Going back to the time of the gift——

A. I owned 90%.

Q. And Mr. Amidon 10%?

A. That is right.

Q. So that your vote would be likely to control any matters that came up?

A. That is true.

If I wanted to be general manager, I certainly had the power to do it. The place of business was the same, and the name of the corporation remained the same except it was changed from R. J. Tower, Inc., to R. J. Tower Iron Works. We left off the "Inc." on our stationery. There was no change in our customers and we sent out no notice of the change. We had about forty employees in 1938 and we did not notify them of the change. The employees, I think, knew it because they could see it from their checks.

I do not remember that Mrs. Tower was reluctant to accept the stock of the corporation. We had some discussion about it. Mrs. Tower was always more or less inclined to feel that whatever I thought was the best for her interest would prove to be that way, and in the discussion between the two of us we felt that would be the way to carry out the program. She naturally was willing to accept a substantial interest in the business. She was satisfied to receive the stock. Mr. Amidon delivered the stock certificate to her. I don't believe I gave it to her personally.

Mr. Amidon did not object in any way to the new partnership arrangement. There might have been some discussion, but I don't recall the details. As I remember it, I wanted him to know what his liability would be in a partnership as compared to a corporation before we asked him to come into that arrangement which might involve personal liability as against giving up an arrangement that involved no personal liability for him. Mr. Amidon
54 did not object in any way to taking on personal liability.

He was in no position to object because I have done quite a little for him. He had been associated with us for a great many years and he probably knew whether he was taking any great risk. He probably knew he wasn't at the time. I stated that I had no personal banking account since about 1933. I used the business account as a clearing house for whatever checks I had to send out.

When it came to income tax matters Seidman & Seidman prepared the accounts and I looked after the payment of the income tax for Mrs. Tower because she is not particularly associated with the daily routine of business affairs. The money thus paid was charged to my personal account, though I can't be sure about that. Mrs. Tower operates our household on a budget and I turn over to her $75.00 a week with which she maintains the operating expenses of the home. During the years in question that was the arrangement that was followed out. During those years I gave her a check every week—a company check, which was charged to my account. She had substantial amounts of money of her own but used no substantial amounts for running the home. Her budget for the home took care of the normal amount of clothing for herself, but if she wanted to buy some particular item she probably did it out of her own funds. I could not tell her she couldn't spend her own money if she wanted to buy a pearl necklace. I don't know of any particular purchase of jewelry she made during the period in question and during that period I wouldn't think that she lived any better than she did before.

Redirect examination by Mr. WAER:

Insofar as the five shares issued to my wife in 1934 are concerned, I did not intend that she should ever give them back to me and I gave them to her with no strings tied to them. In addition to the income tax items paid on behalf of Mrs. Tower, there were other items paid for her from time to time when I gave checks, for instance, buying United States bonds, income tax
55 payments, and other items. I gave her some checks or cash, and it is my recollection that in 1940 she reimbursed me for some of these expenses by tranferring to me a sum of something like $1400.00.

Re-cross-examination by Mr. HUFFAKER:

After the new arrangement with respect to the sharing of the partnership profits, neither Amidon nor I drew a salary and no salaries were paid.

Q. Now, you are faced with this situation, that you were working in the business and Mrs. Tower is not working in the business and still her share of those profits is the same as yours. How do you reconcile that?

A. I don't understand it that way, but Mrs. Tower's shares were at no time equal with mine.

Q. Not in dollars and cents, but in percentage of her rights to the profits. In other words, you gained no advantage by working there, did you? In other words, Mrs. Tower wouldn't have gained any advantage by working, would she?

A. I wouldn't think she would under those conditions.

Q. So, does it seem right to you that your wife should draw the same ratio or same percentage that you did, when she does not work and you do?

A. I think so.

Q. How do you justify that?

A. That is hard to justify, but I think a woman in the house can do as much work as we do working. I felt that way about it.

Q. But in a business arrangement, to draw profits out of a business?

A. She had a right to draw those profits under the terms of the partnership.

Q. Who drew up this partnership agreement?

A. Mr. Waer, our attorney.

The COURT. How was that transfer of $1400.00 made? Was that made by a bookkeeping credit?

A. That is right.

56 The COURT. How much did you consider that Mrs. Tower owed you?

A. I can't tell you exactly, except that I know that she owed me in excess of the amount of the transfer, some $300 or $400 more than that.

The COURT. Does she still make transfers to you now?

A. I can't say exactly. There have been different entries of that kind through Mr. Amidon. Probably it is credited to my account when an accumulation has been made on my account that she wishes to make up to me for things I have paid, such as taxes and maybe cash withdrawals that were made under that system.

The COURT. But Mrs. Tower has her own bank account?

A. She has a personal checking account.

The COURT. At what bank is that?

A. First State Bank of Greenville.

The COURT. The years before us, that takes us back to 1939 and 1940, during those years did she withdraw any amounts from her share of the net profits and deposit them in the checking account?

A. And deposit it in my personal account?

The COURT. In hers.

A. I think she did; I can't remember for sure the amount, but I think she did.

The COURT. Well, she couldn't have paid all these things by her own personal account that you arranged payments for through the business checking account?

A. She could, but she didn't. She only handled small items, personal items for income taxes. She apparently desired me to look after that for her because it had to go through the office; when several accumulated, she either gave me the money or had the transfer made to cover it.

The COURT. Do you remember the meetings?

A. We always had formal meetings when we discussed things.

The COURT. Who decided those things?

A. Mr. Amidon or I decided those things.

The COURT. She does not participate in those decisions?

57 A. No.

The COURT. Matters of strictly business are decided by you and Mr. Amidon?

A. Yes.

The COURT. Well, I think in view of the fact that there was testimony to the effect that Mr. Amidon paid for certain things, having them charged to his account and then adjustments were made in the two personal drawing accounts to balance things up, which you said were reimbursed, I think that the details in these two personal accounts ought to be in the record for the years that come within the taxable year of the petition. I suppose that would not involve any more than introducing photostatic copies of journal sheets; presumably the bookkeeping entries in Mrs. Tower's account are few. The entries are descriptive entries, have descriptions as part of the entries, are they not?

Mr. SEIDMAN. It so happens that one account, the ledger account, and one account, Mr. Tower's account, descriptive accounts, are there, but in Mr. Amidon's account and Mrs. Tower's account you would have to refer back to the journal.

The COURT. I wonder if it would be sufficient to produce a photostatic copy of Mr. Amidon's ledger now? I don't mean to mention Mr. Amidon. I am referring to Mr. Tower's account and Mrs. Tower's account only. Her ledger sheet would have just a few entries and then there would be some journal sheets to explain her ledger entries; is that right?

Mr. SEIDMAN. Yes; there are a number of general entries. I mean a number of entries——

The COURT. The entries are on various journal sheets; you better make a typewritten copy in tabular form of those explanations rather than to have a photostatic copy of all those different journal sheets.

Mr. SEIDMAN. May we do that with the ledger as well, because it is only these two years we want?

The COURT. Yes.

Mr. SEIDMAN. I think that could be sent over some time tomorrow.

The COURT. Well, that wouldn't be asking too much

58 and I would like to have you prepare a schedule; Mr. Huffaker will be here to check it with you.

(Mr. Huffaker thereupon offered and there was received in evidence the following exhibits: Exhibit A, the bylaws of the former

corporation. Exhibit B, minutes of August 23, 1937. Exhibit C, letters signed by Mr. Tower dated July 21, 1937.)

HAZEL I. TOWER, called as a witness for the Commissioner of Internal Revenue, testified as follows:

Direct examination by Mr. HUFFAKER:

In 1939 I received from the limited partnership about $6,000.00 of which $5,000.00 was in cash and $1,000.00 in a check. I can't account for the other $600.00 if I received $6,600, but it probably was in cash. My bank book might reflect a $1,000.00 check, but the cash I kept in our safe at the house. I have a checking account and savings account, but the greatest share of my money is in our safe at home.

Q. Now, when did you first, when did Mr. Tower first approach you or discuss with you anything with respect to this stock of the corporation?

A. That was in 1937.

Q. Would you explain just what took place; what you recall?

A. We had at that time a corporation. There was Mr. Tower, my husband, and Mr. Amidon, the bookkeeper, and myself, and after considerable talking about the thing we found by talking to our attorney and also with our accountants that it would be a wise idea to have a partnership formed from the standpoint that if I was a limited partner, my share, I also had money in the corporation, I had 195 shares, in that partnership I was given 39 percent of the business, and by becoming a limited partner I could have my own money and have my own part of the business that
59 would not be disturbed by either Mr. Amidon or Mr. Tower's investment if they cared to do anything else with their money. It would also protect my children, and by forming a partnership I would not have to pay a corporation tax or some Federal tax.

Q. This was all discussed before the transfer of the corporate stock to you?

A. It was.

Q. What was your reaction?

A. I was very glad to have this.

Q. You didn't resist the stock of the corporation; I mean, you accepted it from Mr. Tower and expected to put it in a partnership?

A. I did.

Q. You received it with the understanding that it was going to be put in the partnership?

A. As my share.

Q. When did Mr. Tower first discuss making this gift to you, if he did?

A. You mean the gift as a bargain?

Q. No; what was the gift that was made to you, if any gift was made to you? Has any gift been made to you of any property?

A. Yes; as a partner I was given this amount of money.

Q. Well, you spoke of having a partnership interest?

A. That is correct.

Q. How did you get the partnership interest?

A. Mr. Tower gave it to me.

Q. Gave you a partnership interest?

A. Yes, sir.

Q. You think he gave you a partnership interest, or he gave you some stock?

A. It wasn't stock in the corporation; it was an interest in the business.

Q. Now, I want you to be sure about that, because we don't want you to state anything you don't believe yourself. Do you know what Mr. Tower gave you?

A. Mr. Tower gave me an interest in the Tower Iron Works. Is that what you mean?

Q. I am asking you what Mr. Tower gave you, if you know.

A. Yes; he gave me 39 shares in the Tower Iron Works.

60 Q. You just said a moment ago you had a 39 percent interest in the partnership business.

A. That is what I mean; you confuse me.

Q. I am trying to disconfuse you now, and I think you are confused. Were you given an interest in this partnership as such?

A. I was.

Q. What did Mr. Tower say to you when he gave you that? What did he say? Did he say, "I am giving you something"?

A. He said he was giving me an interest in the business.

Q. In what business?

A. Tower Iron Works.

Q. What was the business?

The COURT. Was it a corporation?

A. At that time, before the partnership.

Q. Then, what is your understanding of what Mr. Tower gave you. What do you think he has given you?

A. A share in the business.

Q. Of what business?

A. Of his manufacturing business.

Q. Is it your understanding that he has given you a share in the partnership business?

A. Yes.

Q. I wouldn't be too certain about that unless you actually feel certain.

A. I certainly do feel certain.

The COURT. I don't think this is clearing up the difficulty.

Mr. HUFFAKER. Well, your Honor, I can see that, but I did want to see, and I have a good reason for saying, if the witness knows just what was given, in her own mind, what was given, without me placing the words in her mouth. I want to be sure she understands what she received.

The COURT. On the other hand her personal opinion of business matters doesn't make it simple for you to ask the question in terms of accuracy. That is, a person who is given an automobile knows that they have been given an automobile.

61 By Mr. HUFFAKER:

Q. Well, Mrs. Tower, what was handed to you, what was given you? Was it a piece of paper?

A. No.

Q. What was handed, what physical thing was handed to you? Was anything handed to you?

A. No; nothing was handed to me. It was just credited to me on the books.

Q. Did Mr. Tower give you a stock certificate?

A. No.

During the years 1939 and 1940 my husband always gave me $75.00 a week to run our home. This was taken from his part of the profits of the iron works and not from my part of the profits. I received approximately $300.00 a month to run our house and spent practically all of that amount. It cost me approximately $300.00 a month to run the home, but this does not include my personal clothing which I buy myself. It covers lights, gas, telephone, groceries, meats, our church allowance, our allowance to our daughter who is in college, etc. We continued to live the same in 1938 as we had in 1937, and also the same from 1939 to 1940. We didn't live any better in those years than we had before. My husband owns our home which is in his name.

I have an automobile but am not sure whether it is in my name or not. Mr. Tower bought it for me. It is my own car and I use it for myself entirely. I asked him to buy the car for me from the profits of the business. He has a town car of his own. When I wanted the car I asked Mr. Amidon to place to my husband's credit enough money to cover the car and I think it was $1,600.00. I asked Mr. Amidon to place the amount in Mr. Tower's account so he could complete the deal with Mr. Rasmussen, of Greenville, from whom I bought the car. I don't know whether Mr. Tower sent a check or paid cash for the car, but he did it under

my instructions. In 1939 and '40 I had a maid, and help in the house, and paid the same out of my $75.00 a week. I also had a daughter in college and I contributed occasionally out of my own money for her benefit. The rest she got from Mr. Tower. She got none of the household funds for her college expenses.

62 The money that has not been deposited in my checking account has been kept in the safe to which we both have the combination. Neither of us goes into the other's compartment in the safe. When I was subpoenaed I was asked to bring my bank account and canceled checks, but I could not bring the latter because at the end of the year I burn my checks. At the end of the year if there are no outstanding checks, I burn them. I have a charge account in Grand Rapids, and if I have a bill I pay that account with a check.

Mr. WAER. May I call attention to the fact that Mrs. Tower does not have her checks. She obtained a statement from the bank, a complete statement of her own of the checks in question, which we will turn over to counsel.

(Witness continuing:)

This which you handed me is my savings book, and the first entry that appears in 1939 is in February, a withdraw of $228.40. The withdrawals were, in May $1,900.00; and in November $10.00, $23.00, $36.00. The deposits were, February $490.00; November and October $500.00; December $25.00, and January $50.00. This was all in 1939 and 1940. I had an even $1,000.00 in the bank in 1939, and in November my balance was $1,635.17. At the end of 1940 my balance was $2,250.00.

Another book which you hand me is a bank book on the First State Savings Bank of Greenville, and in that the deposits in 1939 and 1940 were as follows: January 1939, $200.00, October $200.00; and in 1940, July $15.00; August $606.50; September $198.09; October 4, $1,000.00; October 22d, $77.00; October 22d, $103.00. Now you have first $1,000, December the 11th, $100, and December 24th, $111.

During 1939 and 1940 there were withdrawals from my checking account. What you hand me is my checking account statement, and it describes the number of checks written against my account during 1939 and 1940 as well as other years, though it does not show to whom the checks might have been written. For 1939 and 1940 I have no checks of any kind. The only items that I can remember in my 1939 and 1940 account because of the amount involved or oddness in figures are checks covering Christ-

63 mas gifts, which checks were drawn in January of 1938, 1939, or 1940.

(Respondent's Exhibit D offered and received in evidence. The exhibit consist of three pages and shows checks drawn against the

witness' checking account during all or portions of 1939 and 1940.)

(Witness continuing:)

During the year 1939 and 1940 I performed no services for the business of the partnership. I have nothing in my possession in the way of a slip of paper to show my interest in the partnership. My husband owns the house in which we live and he pays the taxes on it. The taxes are not paid out of my allowance. Out of my own funds, in addition to buying clothes, I have been paying for half of the bonds we have been buying, at an average of one a month. I also have been interested in a boy in the medical college at the University who is now a lieutenant in Texas in the Medical Corps and I have been helping him around a $1,000. He is not a relative but is a neighbor's boy.

I buy myself some clothes and if I want something for the home I buy it, but I have been keeping most of my money for myself, having done that since 1929 when we had the bank holiday. I have not changed my method of living since I received my interest in the partnership. I was frugal before I got that interest as well as I am now.

Cross-examination by Mr. WAER:

I have seen Exhibit 2 before. It was when Mr. Tower gave me the 190 shares of stock in the corporation and I signed the assignment in the back. Mr. Tower gave me the 190 shares of stock and brought this paper—Exhibit 2—home to me. I put it in the safe until the partnership was started, and then I endorsed it and turned it back to Mr. Tower.

Q. Now, Mrs. Tower, don't be disturbed by having so many questions asked you. Now, you have made a statement that appears to be in contradiction, and I want to ask you some questions to straighten it out. But before I do, I would like to have
64 you tell the Court, sometime before, you testified Mr. Tower never gave you a certificate of stock. In fact, you said he never had any stock certificate issued. Now, when she read your testimony back, you said he gave me this stock and then brought home this paper.

A. That is right.

Q. Now, read the answer back and I will ask some questions, to try to straighten it out.

The COURT. That is what I mean. Did he ever hand you a stock certificate?

A. No.

Q. Then your testimony on that still stands?

A. Yes. Then are you talking about the corporation or the partnership?

The COURT. No; the partnership does not have it, the corporation issued your certificate of ownership.

A. That is what I meant.

The COURT. But that was not a stock certificate?

A. No.

The COURT. And you never saw any stock certificate?

Mr. WAER. May I call attention to the fact that this *is* a stock certificate but it was not made on a printed form due to the few shares held here, they never had any stock certificates.

The COURT. They had no stock certificate book?

Mr. WAER. No.

The COURT. Then this is supposed to be a stock certificate?

Mr. WAER. That is right, your Honor. While it does not have the border in the usual form, it is a stock certificate.

The COURT. Then this accounts for Mrs. Tower's confusion, and I think that clears up that point.

We will have to take a recess and come back. When do you want to come back?

Mr. HUFFAKER. I thought perhaps that two or three minutes might finish this up.

(Witness continuing:)

Later I gave this document, which, while it does not look like a stock certificate, is a stock certificate, back to Mr. Tower.

65 I signed the transfer clause at the bank at the time I gave it back in 1937. In addition to using my funds as I have indicated, I put more than $3,000.00 in a cottage we built on Baldwin Lake in 1939 and 1940. We started buying bonds at the rate of $100.00 a month sometime ago.

Redirect examination by Mr. HUFFAKER:

Mr. Tower saw to the building of the cottage at Baldwin Lake in 1940. The two of us paid for the building of the cottage, and I paid for most of the furniture out of my own money. We furnished the cottage so that we had our Thanksgiving dinner there in 1940. The funds which I furnished toward the cottage and furnishings come from the partnership. I would speak to Mr. Amidon and ask him to draw a check, or send the cash, and the furnishings were handled the same way. I put in a little over $3,000.00 and Mr. Tower put in a little over $5,000.00. We have two children, Pat who was 22 in 1940, and Fran who is seven years younger. She was living at home at the time, and Mr. Tower paid her school expenses.

The COURT. Now you have withdrawn from your earnings of the company about $13,700 in 1940, and Mr. Huffaker asked you some questions about the withdrawals from 1939, and I will now ask you

about withdrawals in 1940. Was that right that you withdrew about $17,500? How much have you taken in cash and how much in checks?

Mr. WAER. The figures you are reading are the undistributed shares.

The COURT. Change the figures $6,403 to $2,032, and the figure $13,724 to $5,000. Then I expect your answer covers the total amount in 1940. You testified that you had received about $5,000 in cash and some by check.

A. That is right.

Q. That much have covered two years, the, 1939 and 1940?

A. If I could see the figures, I could tell.

The COURT. You can't recall that offhand?

A. No.

66 The COURT. You did testify that you had about $5,000 in cash. How did that come into your possession?

A. It was given to me by Mr. Amidon.

The COURT. Then you took it home?

A. I took it home.

The COURT. Did that come to you at one time or at various times?

A. That was in 1939?

The COURT. I don't know, my dear.

A. No; but I mean in 1939.

The COURT. I am just asking you. Your testimony is that altogether you got about $5,000 cash, and I am asking you if you got it all at one time. You got it all at one time?

A. Yes.

Q. Do you keep any record of the money you receive?

A. No, I do not. I know how much my share of the profit is, and at the end of the fiscal year Mr. Amidon notifies me and also Mr. Tower tells me, and when I need money I ask for it.

The COURT. Do you keep any books or records of the money you have on hand?

A. I try to keep a certain amount of money on hand.

The COURT. I said records.

A. No.

The COURT. You say you have a safe; a box in this safe?

A. A box in the safe.

The COURT. Does it have a key to it.

A. Yes.

The COURT. Do you know how much money is in there?

A. Yes.

The COURT. How do you know that?

A. Because I keep a slip of paper and when I take any amount out at all I put a slip of paper in and try to put it back.

The COURT. Have you given any of the money out of that box to Mr. Tower at any time?

A. The only time I ever gave Mr. Tower any money
67 out of the box is when he pays a bill that I think should come out of my own money.

The COURT. How much do you think that amounts to; can you think back a little?

A. The only time I can remember that it was any amount at all was around, I think it was not quite $1,500. Mr. Tower had paid my income tax and had paid for some bonds that we buy together, and he told me that he had paid them and I reimbursed him for it and I asked Mr. Amidon to credit his account with the money.

The COURT. That would be done at the office. I am wondering about that cash box at home. My question is, what money have you given Mr. Tower?

A. None; absolutely none.

The COURT. You have given him none?

A. None.

The COURT. Do you ever spend any time in the business?

A. No.

The COURT. Do you know anything about the business?

A. I do know about it, but I don't know about it from the standpoint—I know about the business transactions. I know when we get new business and what kind of business that is, and I know when our business is up or down.

The COURT. Have you ever made any decisions about employing anybody?

A. No.

The COURT. Have you ever made any decisions or suggestions to any officers of the company?

A. No.

The COURT. Collected any money?

A. No.

The COURT. Buying any machinery for the company?

A. No.

The COURT. Have you ever made any decisions about any of the products of the company?

A. No.

The COURT. Then it is a correct statement to say
68 that you have no connection whatever with the active conduct of the business?

A. That is right.

Mr. HUFFAKER. If the Court please, I would like to call attention to a fact that has just come out in the testimony, to the effect that there are certain records and the subpoena calls for all personal books showing disbursements of any sort should be brought

in, and this account that is kept in this little safe to which there is no key, that would certainly come within the terms of this subpoena, that is the account showing disbursements and receipts.

A. Well, I can explain it, I have been keeping a certain amount of money in this box for some time and if I take any money out, I put in a slip showing how much I have taken out, and when I get a certain amount I put it back and I tear up the slip. Right now it is up to the top.

Mr. HUFFAKER. That is the purpose of a bank book, showing that you take out and put in.

The COURT. It is not unreasonable, but that was understood, what was meant by the subpoena. I think she accounted for the item by her testimony.

(Petitioner's Exhibits 1 to 10, both inclusive, and 12 to 28, both inclusive; Respondent's Exhibits A, B, C, D, and Exhibits requested by Judge Harron [Tr. 75–76]) consisting of Journal and Ledger Entries, are all made a part of this statement of evidence and are to be transmitted to the Circuit Court at such time and in such form and manner as ordered by the United States Circuit Court of Appeals for the Sixth Circuit.)

69 *Stipulation*

It is hereby stipulated by and between counsel for the respective parties as follows:

1. The attached is agreed to as being the transcript of the record to be certified and transmitted by the United States Tax Court to the United States Circuit Court of Appeals for the Sixth Circuit.

2. The exhibits referred to in said transcript need not be printed, but all of the original exhibits may be transmitted by the United States Tax Court to the Clerk of the Circuit Court of Appeals for the Sixth Circuit, such exhibits to remain in the custody of the Clerk of the Tax Court until ten days prior to the hearing before the Circuit Court of Appeals and then transmitted by the Clerk of the Tax Court to the Clerk of the Circuit Court of Appeals for the Sixth Circuit at the expense of the petitioner on review. In connection with the use of said original exhibits in this court, either party shall have the right to refer to the same in the oral arguments before this court, and either party may print, as an appendix to his brief, such portions of any of said exhibits as it may desire.

July 25, 1944.

(S) OSCAR E. WAER,
Attorney for Appellant.
(S) J. P. WENCHEL,
Attorney for Appellee.

70 In United States Circuit Court of Appeals,
Sixth Circuit

Petition for review with proof of service

Filed May 26, 1944

Received July 10, 1944

To the Honorable Judges of the United States Circuit Court of Appeals for the Sixth Circuit:

Francis E. Tower, the appellant, by Oscar E. Waer, his attorney, hereby files this his petition for review by the United States Circuit Court of Appeals for the Sixth Circuit of the decision of the Tax Court of the United States entered on March 3, 1944.

I. JURISDICTION AND VENUE

The appellant is an individual residing at Greenville, Montcalm County, Michigan. His federal income tax returns for the fiscal years, ended July 31, 1940 and July 31, 1941, were filed with the Collector of Internal Revenue of the United States for the District of Michigan, whose office is located at Detroit, Michigan, and within the jurisdiction of the United States Circuit Court of Appeals for the Sixth Circuit, wherein this review is sought pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

II. PRIOR PROCEEDINGS AND FACTS

On February 8, 1943, the Commissioner determined deficiencies in the income taxes of the appellant herein for the fiscal years ended July 31, 1940 and July 31, 1941 in the amounts respectively of $599.55 and $2,758.18, and sent appellant a notice of said deficiencies in accordance with the applicable provisions of the Internal Revenue Laws. Said deficiencies arose from the inclusion by the Commissioner, in the income of the appellant of the distributive share of petitioner's wife, Hazel I. Tower, in the partnership profits of R. J. Tower Iron Works, a limited partnership organized under the Michigan Law.

On April 26, 1943, appellant filed a petition with the Tax Court of the United States for a redetermination of said de-
71 ficiencies. The Commissioner filed an answer to such petition and also an amendment to such answer.

A hearing before the Tax Court was had in Grand Rapids, Michigan, on October 28th and 29th, 1943.

On March 3, 1944, the Tax Court rendered its decision sustaining the determination of the Commissioner in the assessment of

the deficiencies in question. The Tax Court's opinion is officially reported as 3 U. S. Court 49.

III. NATURE OF CONTROVERSY

There is no dispute as to the facts. The only question involved is whether those portions of the income of the limited partnership of R. J. Tower Iron Works for the fiscal years ended August 31, 1939, and August 31, 1940, which belonged to Hazel I. Tower, the wife of appellant, as her distributive share as a partner in said firm, and which were reported as her income in her individual income tax returns, should be taxed to the appellant.

R. J. Tower Iron Works, Inc., was organized as a Michigan corporation on September 9, 1933, with an issued capital stock of 500 shares having a par value of $100.00 a share, or a total of $50,000.00.

Immediately prior to August 25, 1937, 445 shares of this stock were owned by appellant, 50 shares by one Harvey A. Amidon, and 5 shares by appellant's wife, Hazel I. Tower.

On August 25, 1937, appellant made a gift to his wife of 190 shares of the stock, and in connection with such gift he filed a gift tax return and paid a tax thereon.

On August 28, 1937, the corporation was completely liquidated and dissolved, all of the assets of the corporation being transferred to a limited partnership, having the same name and organized under the Michigan law. The partners were the same persons as the former stockholders, and their respective interest in the partnership capital and profits were in the same proportions as their former stock holdings.

The limited partnership continued the business formerly carried on by the corporation, regularly employing from forty to sixty people in its operations and owning assets used in the busi-
72 ness having a value of approximately $200,000.00. The business is composed of a manufacturing plant producing sawmill machinery and metal stampings for the refrigerator trade. Capital was an essential income-producing factor in that business.

As of September 1, 1938, Amidon's interest in the profits of the partnership were increased so that he became entitled to 25% of the profits and the appellant and his wife's interest in the profits were concurrently decreased respectively to 42½% and 32½%. On the basis of the percentage of profits thus agreed upon, there were credited as of August 31, 1939, and August 31, 1940, to the individual capital and drawing accounts of the three partners their respective shares of the profits for the respective periods, the partnership having a fiscal year which ended on August 31st. The

partners all withdrew substantial portions of their respective profits, each partner withdrawing his or her own share.

The Tax Court determined that the distributive share of the income from the partnership belonging to Hazel I. Tower, the wife, belonged to the husband and sustained the determination of the Commissioner of Internal Revenue.

IV. ASSIGNMENTS OF ERROR

The Tax Court erred:

(1) In holding that the gifts of the corporate stock in R. J. Tower Iron Works by appellant to his wife were incomplete, invalid and not bona fide.

(2) In holding that the agreement of limited partnership entered into among Harvey A. Smidon, appellant and his wife on August 28, 1937, did not create a bona fide partnership.

(3) In holding that the wife made no capital contribution to the partnership.

(4) In failing to find that appellant's wife was a partner of R. J. Tower Iron Works.

73 (5) In taxing to appellant the income derived by his wife from her partnership interest in R. J. Tower Iron Works.

(6) In finding that there are deficiencies in appellant's income taxes for the fiscal years ended July 31, 1940 and July 31, 1941, of the amounts respectively of $599.55 and $2,758.18.

The appellant herein, being aggrieved by the said decision of the Tax Court of the United States, and by the said errors, desires to obtain a review of the said decision, and of all the proceedings heretofore had before the said Tax Court, by the Circuit Court of Appeals for the Sixth Circuit, to the end that the errors and omissions of the said Tax Court be corrected and that the said Tax Court be directed to enter an order in the above entitled cause of "No Deficiency."

OSCAR E. WAER.
Attorney for Petitioner and Appellant.

[*Duly sworn to by Francis E. Tower: jurat omitted in printing.*]

74 *Notice of filing petition for review*

Filed May 27, 1944

To: J. P. WENCHEL.
Chief Counsel, Bureau of Internal Revenue.

You are hereby notified that Francis E. Tower did, on the 26th day of May, 1944, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Sixth Circuit, of

the decision of this Court heretofore rendered in the above-entitled case. Copy of the petition for review as filed is hereto attached and served upon you.

Dated this 27th day of May 1944.

(S) B. D. GAMBLE.
Clerk, The Tax Court of the United States.

Service of copy of petition for review acknowledged this May 27, 1944.

(Signed) J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

75 In United States Circuit Court of Appeals, Sixth Circuit

Statement of points to be relied upon by petitioner on review

Filed July 29, 1944

The petitioner on review in the above entitled cause before the Circuit Court of Appeals for the Sixth Circuit, relies upon the following points in connection with such review.

The Tax Court of the United States erred:

1. In holding that the gifts of the corporate stock in R. J. Tower Iron Works by petitioner on review to his wife were incomplete, invalid and not bona fide.

2. In holding that the agreement of limited partnership entered into by appellant and his wife and Harvey A. Amidon on August 28, 1937, did not create a bona fide partnership.

3. In holding that the wife made no capital contribution to the partnership.

4. In finding that there were deficiencies in appellant's income tax for the fiscal years ended July 31, 1940 and July 31, 1941, in the amounts respectively of $599.55 and $2,758.18.

OSCAR E. WAER.
Attorney for Petitioner on Review and Appellant.

76 In United States Circuit Court of Appeals, Sixth Circuit

Order in re exhibits

Filed Aug. 31, 1944

Entered Aug. 28, 1944

Pursuant to stipulation of counsel for the respective parties, it is ordered that in the above entitled cause the original exhibits, instead of being fully set forth in the transcript to be certified by the Tax Court of the United States to this court, may be trans-

mitted by the Clerk of the Tax Court to the Clerk of this Court, said exhibits, however, to remain in the custody of the clerk of the Tax Court until ten days prior to the hearing before this court and to be then transmitted by the Clerk of the Tax Court to the Clerk of this Court at the expense of the petitioner on review. In connection with the use of said original exhibits in this Court, either party shall have the right to refer to the same in the oral argument before this court, and either party may print as an appendix to his brief such portions of any of said exhibits as it may desire.

(Signed) XEN HICKS, *Circuit Judge.*

CINCINNATI, OHIO, August 1944.

A true copy.

Attest:

[SEAL] J. W. MENZIES,
Clerk.

By (S) CARL W. REUSS.
Chief Deputy Clerk.

77 In the Tax Court of the United States

Stipulation for designation of portions of record, proceedings, and evidence to be contained in record on review

Filed Aug. 31, 1944

To the Clerk of The Tax Court of the United States:

It is hereby stipulated and agreed by the respective counsel for the above-named parties that you prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Sixth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Sixth Circuit, heretofore filed by the petitioner on review:

1. Docket entries of all proceedings in the above-entitled cause before The Tax Court of the United States.

2. Pleadings before The Tax Court of the United States as follows:

(a) Petition, including copy of deficiency notice and statement attached.

(b) Answer.

(c) Respondent's motion to amend his answer including amendment to answer.

(d) Reply to amendment to answer.

3. Findings of fact and opinion of Tax Court promulgated March 3, 1944.

4. Decision of the Tax Court entered March 3, 1944.

5. Statement of Evidence.

6. Petitioner's Exhibits 1 to 10, both inclusive, and 12 to 28, both inclusive; Respondent's Exhibits A, B, C, D, and Exhibit not marked for identification but called for by Judge Harron (Tr. 75–76), consisting of journal and ledger entries, such Exhibits to be transmitted to the Circuit Court in such form and manner as ordered by the Circuit Court.

7. Petition for Review filed on May 26, 1944, by the petitioner on review in the above-entitled cause, and notice of filing with acknowledgment of service.

78 Stipulation for Designation of Portions of Record, Proceedings, Evidence to be Contained in Record on Review

8. Statement of Points to be Relied Upon by petitioner on review.

9. Order of Circuit Court in re Exhibits.

10. Order of Circuit Court for enlargement of time.

11. This Stipulation of Designation of Record on Review.

Said transcript to be prepared, certified, and transmitted as required by law and the rules of the Circuit Court of Appeals for the Sixth Circuit.

OSCAR E. WAER,
Counsel for Petitioner on Review.
SAMUEL O. (?) Jr.,
Assistant Attorney General.
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

crm/tls 7-14-44.

[Clerk's certificate to foregoing transcript omitted in printing.]

79 In United States Circuit Court of Appeals, Sixth Circuit

Motion for order extending time

Filed Sept. 11, 1944

Now comes Francis E. Tower, petitioner on review, and moves the court for a further extension of time within which to file transcript of record in the above-entitled cause to and including October 1, 1944.

(Signed) OSCAR E. WAER,
Attorney for Petitioner on Review and Appellant.

We hereby consent to the allowance of the foregoing motion.

(Signed) J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

AUGUST 25, 1944.
Approved:
XEN HICKS, *Circuit Judge.*
[Clerk's certificate to foregoing paper omitted in printing.]

80 In United States Circuit Court of Appeals, Sixth Circuit

Order extending time

Filed July 21, 1944

Pursuant to stipulation signed by counsel for the respective parties:
It is hereby ordered that the time within which to file transcript of record in the above-entitled cause be and is hereby extended to and including September 1, 1944.
Approved for Entry:
XEN HICKS, *Circuit Judge.*
[Clerk's certificate to foregoing paper omitted in printing.]

82 In United States Circuit Court of Appeals, Sixth Circuit

Cause argued and submitted

February 13, 1945

Before SIMONS, MARTIN, AND MCALLISTER, JJ.
This cause is argued by Oscar E. Waer for Petitioner and by S. Dee Hanson for Respondent and is submitted to the court.

In United States Circuit Court of Appeals, Sixth Circuit

Judgment

Entered: April 2, 1945

On petition to review decision of the Tax Court of the United States.
This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.
On Consideration Whereof, It is now here ordered, adjudged and decreed by this Court that the decision of said Tax Court in this cause be and the same is hereby reversed and the cause remanded to the Tax Court for further proceedings in conformity with the opinion of this court.

84 In United States Circuit Court of Appeals, Sixth Circuit

No. 9868

FRANCIS E. TOWER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition to Review the Decision of the Tax Court of the United States

Before SIMONS, MARTIN, and MCALLISTER, Circuit Judges.

Opinion

Filed April 2, 1945

SIMONS, Circuit Judge. This case, involving the question whether a wife's share of the earnings of a partnership are taxable to her or to her husband from whom her interest in the partnership is derived, is a close one, and falls somewhere in the area between the Second Circuit's decision in Humphreys v. Commr., 88 Fed. (2d) 430, and decisions in the Fifth and Tenth Circuits in Mead v. Commr., 131 Fed. (2d) 325, and Earp v. Jones, 131 Fed. (2d) 292, respectively.

The taxpayer, in 1933, owned 425 shares out of a total of 500 shares of the R. J. Tower Iron Works, Inc., the remaining 75 shares being held by two employees of the corporation, Amidon having 50 shares and Lawrance having 25 shares. In 1934 the taxpayer purchased Lawrance's stock and made a gift of 5 shares to his wife, who was made a director and vice-president of the corporation, so that subsequently, and until the tax years here involved, the taxpayer owned 445 shares of the company. In July 1937, after some discussion with his wife and Amidon in regard to the advisability of dissolving the corporation and setting up a partnership, and all concluding that this would result in tax savings and avoid the necessity of filing multitudinous cor-

85 porate reports, it was decided that the taxpayer would transfer some of his stock of the corporation to his wife, so that she would be able to contribute a substantial part of the partnership capital. In furtherance of this decision, the taxpayer, on August 25, transferred 190 shares of his corporate stock to his wife, upon condition that she would contribute the corporate assets, which the shares represented, to the new partnership. The transfer was recorded on the corporate books, a new stock certificate was issued and delivered to the wife, and the taxpayer filed

a gift tax return, and paid the taxes shown to be due thereon. Thereafter, the corporation was completely liquidated and a limited partnership agreement entered into between the taxpayer, his wife, and Amidon, for the purpose of carrying on the business of the corporation, all of the assets of which were transferred to the partnership.

The partnership agreement was to be for 20 years, unless sooner terminated by a majority in interest of the partnership capital. The taxpayer and Amidon were general partners, and Mrs. Tower was a limited partner. Tower's contribution to partnership capital was $81,600; his wife's was $62,400; Amidon's was $16,000. The partners were to share in the profits and losses in proportion to their respective contributions to capital, except that Mrs. Tower was not to be liable for losses in excess of her contribution. The general partners were to have the exclusive management and control of the business, the right to fix salaries, and were to distribute the net profits for each year at such times as they might determine. The taxpayer's share of the partnership profits amounted to 51 percent, his wife's to 39 percent, and Amidon's to 10 percent. Amidon had formerly been employed by the corporation as bookkeeper and continued to perform similar work for the partnership until the early part of 1938 when, by reason of additional responsibilities and duties devolving upon him because of increase in the volume of business, the Towers felt that he was entitled to a larger share in the profits, and they were increased on September 1, 1938, from 10 percent to 25 percent, with proportionate decreases to the Towers. It was then also agreed between Tower and Amidon, that neither would draw salaries for future services.

Mrs. Tower, as vice-president and a director of the corporation after the withdrawal of Lawrance, attended directors' and stockholders' meetings, but was not actively engaged in the business,
86 nor did she render service to the partnership or draw salary therefrom. Prior to the partnership agreement the taxpayer gave his wife a regular allowance of $75 a week for household expenses, and this allowance continued during the taxable years. She had a savings and checking account at the bank, wherein she deposited some of the money received from the partnership, and kept some in the form of cash in a safe at home. Following the bank holiday, the taxpayer also kept money and papers in the safe, but used a separate box. In 1940 the Towers built and furnished a summer cottage, Tower contributing approximately $2,000 thereto, and his wife $3,000. During that year Mrs. Tower also repaid her husband some $1,400 which he had advanced for the payment of her income taxes and other expenses. They bought war bonds together, each contributing one-half of

the purchase price. The taxpayer performed the same services for the partnership that he had previously performed for the corporation. Upon the basis of these circumstances substantially as found by the tax judge, it was concluded that the gift of corporate stock by the taxpayer to his wife in 1937, was not valid and complete, in that the wife did not gain full dominion and control over the shares, so that she was not a bona fide partner in the business during the taxable years. Deficiencies asserted by the Commissioner in Tower's income tax for the fiscal years ending July 31, 1940, to and including July 31, 1941, based upon the inclusion in his income of the amounts withdrawn by or credited to the wife from the earnings of the partnership, were therefore sustained.

The tax judge reasoned that the taxpayer did not relinquish control of the stock transferred to his wife since she could use it in but one way, namely, to place corporate assets, which the stock represented, into the partnership. Because of the condition attached to it, the transfer did not constitute a valid and complete gift of shares. There was no purpose and intent to vest absolute dominion over the shares in the wife, and since she lacked untrammeled freedom in their disposition, she made no capital contribution to the partnership, and was not a bona fide partner. The conclusion that the transfer was invalid as a gift is rested on the ground that title, dominion, and control of the subject matter were not, in praesenti, conveyed. Reliance is chiefly placed on Edson v. Lucas, 40 Fed. (2d) 398 (C. C. A. 8), where essential elements of a gift inter vivos, are catalogued. In that case, however, the conditions attached to the gift went far beyond that here involved, including reversion of the subject matter to
87 the donor. Notwithstanding, the gift was sustained, Judge Sanborn, after an exhaustive analysis of cases, arriving at the conclusion that a gift is not invalid because of conditions imposed by the donor which are not inconsistent with the immediate vesting of such legal title in the donee. The case is authority for the validity of a gift, even though coupled with a condition subsequent which doesn't interfere with the vesting of title in the donee. Such was the gift here involved.

Granted, however, that, because of the condition, Tower's gift was not complete at the time he gave the shares to his wife, the condition was almost immediately performed. The gift was then both valid and complete, vesting title in the wife to the corporation assets contributed by her to the partnership capital. The question that remains is whether the gift was bona fide or a mere sham. We know of no rule, statutory or otherwise, which requires that a gift within the family must, without more, be ignored for tax purposes, and have frequently given effect to such gifts. Commr. v. Olds, 60 Fed. (2d) 252; Rose v. Commr., 65 Fed. (2d)

616; Tracy v. Commr., 70 Fed. (2d) 93.[1] It is true that in family trust cases stemming from Helvering v. Clifford, 309 U. S. 331, any arrangement by which income is spread among the members of a single family is subject to severe scrutiny, but adjudication has invariably been based upon the measure of control reserved by the donor over the subject matter of the gift, in order to determine whether the giving was actual or unreal. So it is also in the cases where wholly owned corporations are formed or utilized for the purpose of establishing a reorganization or a realized loss or gain, as in Gregory v. Helvering, 293 U. S. 465, and Higgins v. Smith, 308 U. S. 473. The control of the corporation may be so absolute that neither gain nor loss is realized, and the taxing authority may treat the transaction as really it is, rather than as what it seems to be.

Control over the subject matter of a gift may, by express reservation or subsequent exercise, be so substantial as to support a conclusion that no gift was either made or intended. This was so in Mead v. Commr., supra, and Earp v. Jones, supra, where, in each case, no substantial change was effected by a conveyance from a taxpayer to his wife of an interest in his business, with
88 no actual distribution to the wife from the earnings of the partnership, and continued treatment of the wife's share of earnings by the taxpayer as though they were his own. In each case the tax court was held to have been justified in treating the gift as lacking in bona fides, and a mere artifice. In Humphreys v. Commr., supra, where wives were the partners of their husbands in a public accounting and auditing business to which the wives had contributed capital, it was sought to allocate earnings withdrawn or credited to the wives as income of their husbands, on the ground, here also relied upon, that they contributed nothing to the activity of the partnership, the income of which was earned wholly through the personal services of their husbands. But the wives had contributed capital substantially used in the activity, and they were held to be, in every sense, partners, sharing in its profits and liable for its losses. No justification was perceived for treatment of their profits from the firm as income derived from the earnings of their husbands. It is important to note that in the opinion of the Board of Tax Appeals, in that case, it was conceded that the conclusion contended for by the taxpayers would be persuasive if the partnership had been a trading partnership rather than one deriving its income from personal service. The partnership here involved is undoubtedly

[1] In cases reviewed by the full panel, the tax court generally has held that a valid gift of an interest by a husband to his wife gives the wife a separate right to the income, Scherer, 3 T. C. 776; Johnston, 3 T. C. 799; Zukaitis, 3 T. C. 814; Smith, 3 T. C. 894, though the single judge, here deciding, there dissented.

in that category, even though its primary function may be manufacturing.

The respondent, however, argues, and the tax judge concluded, that the present partnership serves no business purpose, and so is kin to the corporation adjudicated, for tax purposes, as unreal in Higgins v. Smith, supra, and this on the ground that the change added no new capital to the business, and that after the formation of the partnership the business had the same capital, assets, liabilities, management, plant, customers, employees, and name as had the predecessor corporation. It is a novel concept. Were it to prevail then no matter what the advantages might be, tax-wise or otherwise, in transforming a closely held corporation into a partnership, such change would never, for tax purposes, be recognized. Once a corporation always a corporation, in the eyes of the taxing authority. That there are business advantages, aside from tax savings, under certain cicumstances, in doing business as a partnership rather than as a corporation, we have no doubt. Even if not, it cannot reasonably be said that a saving in taxes may not, in and of itself, be a legitimate business purpose if the
89 transformation is from one form of business organization to another, and not mere artifice. Clearly, this was so held in Chisholm v. Commr., 79 Fed. (2d) 14 (C. C. A. 2).

It is somewhat late in the history of tax legislation and adjudication, to urge that there is an unlawful purpose in a taxpayer's election of that form for doing business which is more advantageous to him. It is true that the government may look at actualities, Higgins v. Smith, supra, and may determine that the form employed is unreal or a sham, and if so, disregard the effect of the fiction. But as Judge Learned Hand said in the Chisholm case, supra, "The question always is whether the transaction under scrutiny is in fact what it appears to be in form. * * * A contract may be intended only to deceive others; an agreement may have a collateral defeasance. In such cases the transaction as a whole is different from its appearance." As in the Chisholm case, the purpose of the case at bar was to form an enduring firm which should continue for 20 years, and has so continued through the tax years and since.

Returning to the facts of the case, there is no evidence upon which to base a conclusion that either the gift of corporate shares to the wife, or the organization of the partnership, was unreal and a mere artifice. The taxpayer exercised no such control or dominion over the monies withdrawn by the wife from the earnings of the firm as to demonstrate a "collateral defeasance." They were deposited in her own bank account and used, so far as the record discloses, at her own volition and for her own purposes. The fact that she repaid the taxpayer for advances made by him

in the payment of her income taxes and other expenses, emphasizes the separateness of the wife's funds from those of her husband, rather than their joint character. That each contributed to the purchase and furnishing of a summer cottage to be used by the wife's family, is not so unusual as to indicate, in absence of other circumstances, control by the husband over the income of the wife from the partnership. Her share of firm earnings was subject to withdrawal by her alone. It is a far cry from the facts of the present case to those of Johnson v. Commr., 86 Fed. (2d) 710 (C. C. A. 2), where the taxpayer gave borrowed money to his wife to set up a trust for the payment of insurance on his own life, borrowing the corpus from the trustee with interest pay-
90 ments voluntary.[2] We are fully cognizant of the finality of determinations by the tax court, but we do not understand that Dobson v. Commr., 320 U. S. 489, is destructive of the long-established rule that factual determinations must be supported by evidence, and that administrative decisions must have "warrant in the record."

Reversed and remanded to the tax court for further proceedings in conformity herewith.

Dissenting opinion

MARTIN, dissenting. This case was, in my judgment, correctly decided by the Tax Court upon its findings of fact, amply supported by evidence, that the petitioner's wife made no actual contribution, either of capital or of services, to the partnership, had no voice in its conduct, and received a portion of the profits, not really as a partner, but only by virtue of her marital relationship; and that there was no real partnership between the petitioner and his wife for the conduct of a business enterprise. The petitioner, being the person who earned the income which was credited to his wife's account, was, therefore, taxable on the income which he sought to attribute to his wife.

In my view, the opinion of the Tax Court, moreover, conforms to the reasoning of the Supreme Court authorities which it cites, and also to the rationale of Mead v. Commissioner of Internal Revenue, 131 F. (2d) 323 (C. C. A. 5), and Earp v. Jones, 131 F. (2d) 292 (C. C. A. 10), both of which cases seem closely in point. Humphreys v. Commissioner of Internal Revenue, 88 F. (2d) 430 (C. C. A. 2), seems to me to be far afield from the case at bar in factual circumstances.

Even were I in disagreement with the inferences drawn by

[2] Harrison v. Schaffner, 312 U. S. 579, but sustains the taxation to the donor of assigned future income, following Helvering v. Horst and Helvering v. Eubank, 311 U. S. 112. The legal effect of the difference between grants of income and a real transfer of the *res* which produces income is there still recognized, as it also is in Helvering v. Douglas Stuart, 317 U. S. 154, 168.

the Tax Court, the strong inhibitions which, to my thinking, have been placed by the highest authority upon the function of appellate court review in a tax case of this character would prevent my concurrence in reversal. Reference is made to expressions of the Supreme Court in Dobson v. Commissioner, 320 U. S. 489, 498, 501, 502; Commissioner v. Heininger, 320 U. S. 467, 475; Commissioner v. Scottish American Investment Company, 323 U. S. 119, 124, 125; and Commissioner of Internal Revenue v. Wemyss, — U. S. —, decided March 5, 1945. Cf. Merrill v. Fahs, U. S. Collector of Internal Revenue, — U. S. —, decided March 5, 1945.

94 Petition for rehearing governing 20 pages filed April 23, 1945, omitted from this print. It was denied, and nothing more by order of May 14, 1945.

114 In United States Circuit Court of Appeals, Sixth Circuit

Order denying petition for rehearing

Entered May 14, 1945

Judge MARTIN, for the reasons stated in his dissenting opinion, thinks the petition for rehearing should be granted.

A majority of the court being of the view that the petition for rehearing in the above cause should be denied.

It is so ordered.

115 [Clerk's certificate to foregoing transcript omitted in printing.]

116 Supreme Court of the United States

Order allowing certiorari

Filed October 8, 1945

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted, and the case is transferred to the summary docket and set to follow No. 263, Lusthaus vs. Commissioner of Internal Revenue.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice JACKSON and Mr. Justice BURTON took no part in the consideration or decision of this application.

[Endorsement on cover:] File No. 50020. U. S. Circuit Court of Appeals, Sixth Circuit. Term No. 317. Commissioner of Internal Revenue, Petitioner vs. Francis E. Tower. Petition for a writ of certiorari and exhibit thereto. Filed August 13, 1945. Term No. 317 O. T. 1945.

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No. 317

Supreme Court of the United States

OCTOBER TERM, 1945

COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

FRANCIS E. TOWER,

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1945

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

FRANCIS E. TOWER

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Acting Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit entered in this case.

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 15–28) are reported at 3 T. C. 396 and the opinion of the Circuit Court of Appeals (R. 82–87) at 148 F. 2d 388.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 2, 1945 (R. 81) and petition for rehearing was denied May 14, 1945 (R. 89). The jurisdiction of this Court is invoked under

Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Circuit Court of Appeals erred in reversing the Tax Court's decision that there was not in substance a contribution of capital to the business by taxpayer's wife and no real partnership between them and that taxpayer earned the partnership profits credited to the wife's account during the years in question, with the result that he is taxable upon them under Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or

gains or profits and income derived from any source whatever. * * *

(26 U. S. C., Sec. 22.)

* * * * * *

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C., Sec. 181.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

STATEMENT

The facts as found by the Tax Court (R. 16–21) are as follows:

Since 1927 taxpayer has operated and managed the R. J. Tower Iron Works, located at Greenville, Michigan, engaged in the manufacture and sale of sawmill machinery and wood and metal stampings. On September 9, 1933, the business was incorporated under the name of "The R. J.

Tower Iron Works, Inc." The outstanding stock consisted of 500 shares of a par value of $100 per share, of which taxpayer received 425 shares, Harvey A. Amidon 50 shares, and H. J. Lawrance the remaining 25 shares. The by-laws required that the directors hold stock in the corporation and the three stockholders were the directors. Taxpayer was president of the corporation and Amidon secretary and treasurer. About six months after the corporation was organized, in the early part of 1934, taxpayer purchased Lawrance's 25 shares of stock and Lawrance severed his connection with the company. Taxpayer immediately made a gift of five shares of stock to his wife, who was made a director and vice-president of the corporation. Taxpayer then owned 445 shares, his wife five shares, and Amidon 50 shares. (R. 16.)

A tentative operating statement as of July 31, 1937, showed that the business of the corporation had been successful and that substantial profits had been realized in the year 1937. In July, 1937, after discussing the matter with his wife, taxpayer talked to Amidon with regard to the advisability of dissolving the corporation and setting up a partnership. Amidon, who had worked in the business for a long time, kept the books of the corporation under taxpayer's supervision. He had no objection to the formation of a partnership and believed the change would not create any great risk so far as he personally

was concerned. Consultations were held with taxpayer's attorney and accountant, who took care of taxpayer's tax matters. They were all of the opinion that the formation of a partnership would result in tax savings as well as eliminate the necessity of filing various corporate returns. It was decided that taxpayer should transfer stock of the corporation to his wife so that she would be able to contribute a substantial share of the partnership capital. (R. 16–17.)

On August 25, 1937, taxpayer transferred to his wife 190 shares of the corporate stock owned by him. The transfer was conditional upon the wife's placing the corporate assets which the shares represented into the new partnership. The transfer was recorded on the corporate books and a new stock certificate was issued and delivered to taxpayer's wife. Taxpayer paid a gift tax of $213.44 on the transfer. (R. 17.)

The corporation was completely liquidated on August 28, 1937, three days after taxpayer transferred the 190 shares of stock to his wife, and was dissolved on August 30, 1937. On August 28, 1937, the day the corporation was liquidated, taxpayer, his wife, and Amidon executed a limited partnership agreement and all of the assets and liabilities of the corporation were transferred to the partnership. (R. 17.)

The partnership agreement provided that the business was to be carried on for a period of 20 years unless sooner terminated by a decision of

the majority in interest in the partnership capital; that taxpayer and Amidon would be general partners and taxpayer's wife a limited partner; that taxpayer's contribution to the partnership capital was $81,600, his wife's $62,400, and Amidon's $16,000; that the partners would share profits and losses in proportion to their respective contributions to capital, except that taxpayer's wife was not liable for losses in excess of her capital contribution; that the general partners were to have the exclusive voice in the management and control of the business and were authorized to determine the salaries of the general partners; that if the majority of general partners [taxpayer and Amidon] were unable to agree, a majority of the general partners in capital interest [taxpayer] would control; and that the net profits for each year would be distributed at such times and in such manner as the general partners [taxpayer and Amidon] might determine. A certificate of limited partnership was filed with the clerk of the county court and notice of the liquidation of the corporation and formation of a partnership was given to those banks with which the corporation had transacted business. (R. 17–18.)

Under the partnership agreement taxpayer's share of the partnership profits and losses amounted to 51%, his wife's share to 39% and Amidon's share to 10%. Amidon had formerly been employed by the corporation as a bookkeeper

and he continued to perform similar work for the partnership. In the early part of 1938 Amidon's responsibilities and duties increased as a result of an increase in the volume of business. Accordingly, his share of the profits was increased from 10% to 25% on September 1, 1938. Thereafter taxpayer received 42½% of the profits and his wife 32½%. The change in the distribution of profits was orally agreed upon and the original agreement and partnership certificate on file with the county clerk were not formally amended. It was also orally agreed that taxpayer and Amidon would not withdraw any future salary for their services. The original capital contributions of the partners remained the same. (R. 18–19.)

Although taxpayer's wife was vice-president and a director of the corporation after the withdrawal of Lawrance and before the formation of the partnership, she did not render any independent services to the corporation, was not actively interested or engaged in the business, and received no salary. In matters pertaining to the business she relied upon taxpayer's judgment. After the formation of the partnership taxpayer's wife rendered no services to the partnership and received no salary. (R. 20.) Taxpayer performed the same services for the partnership as he had previously performed for the corporation. He received no salary after Amidon's share of the profits was increased. The partnership car-

ried on the same business formerly carried on by the corporation and had the same customers. (R. 21.)

Partnership accounts were maintained on an accrual basis for the fiscal year ending August 31. Capital accounts were opened on the books of the partnership showing the amounts contributed by each partner. Distributive shares of the profits were credited either to the capital account or to the drawing account of each individual partner and the respective withdrawals of each partner were charged to their drawing accounts. For the fiscal year ending August 31, 1939, taxpayer's distributive share was $8,710.74, his wife's share $6,661.16 and Amidon's $5,123.97. For the fiscal year ending August 31, 1940, taxpayer's share was $18,253.51, his wife's $13,958.57 and Amidon's $10,737.36. Taxpayer's wife withdrew $2,032.80 for the year ending August 31, 1939, and $5,000 for the year ending August 31, 1940. (R. 19–20.) Some of the money she placed in her own savings and checking accounts and some she placed in a box at home in a safe to which both she and taxpayer had the combination. Since the bank holiday in 1933 taxpayer has kept all of his money and papers in this safe, although he used a separate box. (R. 20.)

Prior to the partnership agreement, taxpayer gave his wife a regular allowance of approximately $75 a week for household expenses. After the formation of the partnership and throughout

the taxable years taxpayer continued to give his wife an allowance of $75 a week for household expenses and for her support, although she paid for some of her own clothes. Taxpayer also paid the expenses of a daughter in college. During the year 1940 taxpayer and his wife built and furnished a cottage at Baldwin Lake, taxpayer contributing approximately $2,000 and his wife contributing $3,000. During that year taxpayer's wife also repaid taxpayer the sum of $1,403.88, which represented expenditures made by taxpayer for his wife's income tax and certain other expenses. They bought a $100 war bond each month and each contributed one-half of the purchase price. (R. 20–21.)

On the basis of these facts, the Tax Court concluded that since taxpayer's gift of stock to his wife was conditional it did not confer full dominion and control over the shares and was not a valid gift *in praesenti*; that the wife therefore made no capital contribution to the partnership; that there was no real partnership between taxpayer and his wife for the conduct of a business enterprise; and that the partnership profits credited to the wife's account during the years ending July 31, 1940, and July 31, 1941, are taxable to taxpayer. (R. 21–28.) The Circuit Court of Appeals reversed, holding that the profits credited to the wife's account are taxable to her rather than to her husband because the gift from husband to wife became complete upon formation

of the partnership if not before, giving the wife an interest in the partnership, and that, since there was no showing that the wife's share of the partnership income was under taxpayer's control, the partnership was bona fide and not unreal or a mere sham. (R. 82–87.)

REASONS FOR GRANTING THE WRIT

I

The decision of the court below is in direct conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Lusthaus* v. *Commissioner*, 149 F. 2d 232, application for certiorari pending, and with the decisions of the Circuit Court of Appeals for the Tenth Circuit in the companion cases of *Grant* v. *Commissioner* and *Strong* v. *Commissioner*, decided July 19, 1945 (1945 P-H, par. 72,626). The court below held that a partnership between the petitioner and his wife was required to be recognized for tax purposes for the reason that legal title to shares of stock, given conditionally by taxpayer to his wife, or at least to the assets which they represented and which were afterward contributed in her name to the partnership, vested in her and there was an actual distribution of partnership earnings to her, the petitioner not having treated her share of the partnership earnings as his own.

In the *Lusthaus* case, as here, the husband made a gift to his wife to enable her to make a capital

contribution to the partnership into which his business was transformed, and after the formation of the partnership the wife was credited with her share of the profits and withdrew some of them. The Circuit Court of Appeals for the Third Circuit assumed that the arrangement complied with the formalities of Pennsylvania law but held that substance rather than form controls, that the partnership status must be genuine with a change in economic interests, and that the Tax Court was free to conclude that the conduct of the parties with reference to the business did not change, that the taxpayer did not divest himself irrevocably of the subject matter of the gift, and that the wife made no real contribution to the capital of the partnership.

The situation in the *Grant* and *Strong* cases was similar except that there the members of an existing partnership transferred to their wives an interest in its assets and organized a new partnership with the wives as partners. The decision of the Circuit Court of Appeals affirming the Tax Court's decision is based on the same principles as those followed in the *Lusthaus* case. Not only did the court below apply criteria rejected by the Circuit Courts of Appeals for the Third and Tenth Circuits as controlling but its employment of different criteria induced a review of the Tax Court's decision extending beyond the scope of judicial review deemed appropriate by those courts. The holding in the other cases is (1) as

to substance, that the issue in cases of this character is whether the wife actually made a contribution of capital and whether the family partnership arrangement produced a genuine change in the husband's economic position instead of constituting simply an attempted allocation of business income, and (2) as to procedure, that the Tax Court's conclusion upon these matters is controlling if it has a rational basis in the evidence.

The decision is also inconsistent with *Earp* v. *Jones*, 131 F. 2d 292 (C. C. A. 10th), certiorari denied, 318 U. S. 764, and *Mead* v. *Commissioner*, 131 F. 2d 323 (C. C. A. 5th), certiorari denied, 318 U. S. 777 (see also *Argo* v. *Commissioner*, (C. C. A. 5th), decided June 20, 1945-(1945) P-H, par. 72, 588)), in each of which the wife contributed to a partnership with her husband capital which was given to her by the husband. Although in these cases and some others, the failure of the wife to actually withdraw profits from the business for her unrestricted use was one factor indicating a lack of substance to the partnership arrangement, no court has previously stressed this factor as controlling, as did the court below.[1]

[1] See also *Waldburger* v. *Helvering*, 131 F. 2d 598 (C. C. A. 2d), affirming *per curiam* the decision of the Board of Tax Appeals (1941 P-H B. T. A. Memorandum Decisions, par. 41,438); *Tinkoff* v. *Commissioner*, 120 F. 2d 564 (C. C. A. 7th); and *Doll* v. *Commissioner*, 149 F. 2d 239 (C. C. A. 8th), application for certiorari pending. These cases involve purported family partnerships unaccompanied by alleged gifts of business property from the husband to the wife; the wife, or wife and children, have simply been declared in some form to be partners. Such cases present a less difficult situation

II

The decision of the court below conflicts in principle with decisions of this Court on related issues. In respect to income from capital, which is taxable to the person who owns the income-producing property, it is axiomatic that ownership for tax purposes is not circumscribed by refinements of legal title. This Court has repeatedly held that taxation is an intensely practical matter concerned with economic realities and that command over property or enjoyment of its economic benefits mark the real owner for income tax purposes. *Helvering* v. *Clifford*, 309 U. S. 331; *Helvering* v. *Stuart*, 317 U. S. 154; *Harrison* v. *Schaffner*, 312 U. S. 579; *Douglas* v. *Willcuts*, 296 U. S. 1; *Corliss* v. *Bowers*, 281 U. S. 376; *Burnet* v. *Wells*, 289 U. S. 670. Similarly, tax consequences flow from the substance of a transaction rather than from its form. *Commissioner* v. *Court Holding Co.*, 324 U. S. 331; *Higgins* v. *Smith*, 308 U. S. 473; *Griffiths* v. *Commissioner*, 308 U. S. 355; *Gregory* v. *Helvering*, 293 U. S. 465; *Weiss* v. *Stearn*, 265 U. S. 242; *United*

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than those which do involve attempted gifts of capital, and no conflict of decisions or failure of a Circuit Court of Appeals to accept Tax Court findings exists with regard to them. The *Doll* case, therefore, does not involve the complex questions which are present in the instant one. The Commissioner, who filed a brief in opposition to certiorari in that case, has filed an additional memorandum setting forth the relationship between the two cases, suggesting that the Court may wish to grant certiorari in that case so that all phases of the family partnership as a tax avoidance scheme may be considered.

States v. *Phellis*, 257 U. S. 156; *Gulf Oil Corp.* v. *Lewellyn*, 248 U. S. 71; *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330. In applying these principles, as the Court has held, the independent existence of a legally created trust may be disregarded (*Helvering* v. *Clifford*, *supra*; *Hormel* v. *Helvering*, 312 U. S. 552; *Helvering* v. *Stuart*, *supra*; *Corliss* v. *Bowers*, *supra*; *Douglas* v. *Willcuts*, *supra*; *Burnet* v. *Wells*, *supra*), as may the independent existence of a legally created corporation which is unreal or a sham, serving no business purpose (*Gregory* v. *Helvering*, *supra*; *Griffiths* v. *Commissioner*, *supra*; *Higgins* v. *Smith*, *supra*). The opinion of the Court in *Helvering* v. *Clifford*, *supra*, furthermore established the principle that a legally perfect gift of income-producing property will not relieve the donor of the tax on the income therefrom in a case where the transfer is an intra-family arrangement which leaves the transferor with incidents of control sufficient to support the conclusion that his economic position has not changed and that he is in substance the true owner. See also *Hormel* v. *Helvering*, *supra*; *Helvering* v. *Stuart*, *supra*; *Helvering* v. *Fuller*, 310 U. S. 69, 76. As a corollary to this doctrine, it is a cardinal rule, established by decisions of this Court, that he who earns or is vested with the right to receive income may not escape taxation upon it by any kind of anticipatory arrangement whereby he procures payment to another. *Helvering* v. *Horst*,

311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner, supra; Douglas* v. *Willcuts, supra; Burnet* v *Leininger*, 285 U. S. 136; *Lucas* v. *Earl*, 281 U. S. 111; *Commissioner* v. *Harmon*, 323 U. S. 44. In determining whether a transaction is in substance an anticipatory assignment of income or a transfer of economic ownership of that which produces the income, the Tax Court is entitled to view the separate steps in a transaction as a whole (*Commissioner* v. *Court Holding Co., supra; Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231); and its conclusion as to the substance of the transaction is conclusive if supported by evidence (*Commissioner* v. *Court Holding Co., supra; Helvering* v. *Clifford, supra*).

In contrast to the postulates of these decisions, the reasoning of the court below rejects as irrelevant the Tax Court's findings that taxpayer's wife made no capital contribution to the partnership and admittedly performed no services, that no real partnership existed between taxpayer and his wife for the conduct of a business enterprise, and that taxpayer earned the income credited to his wife's account. Instead of accepting the conclusion to which these findings almost inevitably lead, the court below held in effect that a formal transfer to the wife of legal title to a part of the husband's interest in a partnership is effective for tax purposes to split the partnership income between them provided only that there be a distribu-

tion of earnings to the wife and that the record does not demonstrate that the husband treated as his own the wife's share of the partnership profits. (See R. 87.)

On what appears to be its turning point that the question whether the partnership should be recognized for tax purposes depends upon the showing made with respect to control by the husband over his wife's share of the partnership income—the decision below is in further conflict of principle with cases decided by this Court. A conclusion as to whether the partnership should be given effect taxwise is a conclusion as to the substance of the partnership arrangement, and substance is in turn dependent upon economic realties. Economic gain to, or economic ownership of the property by, taxpayer does not depend solely upon control over the distribution of the income attributed to the wife. Decisions of the Court with respect to trusts make it clear that control over the property producing the income may be sufficient (*Helvering* v. *Clifford, supra*), and further that economic gain may be realized where, as here, taxpayer had such control over his wife's partnership interest as to enable him to benefit his own partnership interest. See *Helvering* v. *Stuart, supra*; *Burnet* v. *Wells, supra*; *Helvering* v. *Fuller, supra*, p. 76, and footnote, p. 72. Nor is it necessarily without significance that taxpayer derived economic satisfaction from his wife's use of her share of the partnership profits

for purposes, such as acquisition of a summer cottage, for which taxpayer would ordinarily have furnished the funds.

The decision below, contrary to the principle laid down by this Court in *Dobson* v. *Commissioner, supra,* fails to give effect to findings of the Tax Court which make it clear that taxpayer controlled the distribution of partnership income to his wife. It is clear that taxpayer could determine the time for and manner of distribution of partnership profits, for, as the Tax Court found, under the partnership agreement taxpayer and Amidon were authorized to make these determinations and taxpayer's decision controlled if they failed to agree, since he was the majority of the general partners in capital interest. (R. 18.) Other findings of the Tax Court reflecting taxpayer's complete control of the business make it apparent that the production of partnership income depended upon his will. In a real sense, therefore, the partnership earnings were subject to his disposition. Cf. *Burnet* v. *Leininger, supra,* especially as interpreted by Judge Learned Hand in *Rossmoore* v. *Commissioner,* 76 F. 2d 520 (C. C. A. 2d).

Finally, the facts regarding taxpayer's gift to his wife to enable her to make a capital contribution to the partnership make it evident that the alleged contribution was in substance his and that, accordingly, he was the one who, through

capital and services, earned the income attributed to his wife. This is the only logical conclusion possible if the decisions of this Court that substance and not form controls (*supra*, pp. 13–15) are to be given effect. On no valid ground could the Tax Court's conclusion properly be overturned.

III

The question presented in this case is an important one in the administration of the tax laws and should be settled by this Court. The family partnership device for tax avoidance has apparently been resorted to increasingly since this Court's decision in *Helvering* v. *Clifford*, *supra*, foreclosed the use of trusts as a means of tax avoidance. The result is a substantial growth in the number of family partnership cases.[2] We are advised that 221 such cases are now pending before the Tax Court, involving $4,719,000 in taxes.[3] While the facts of these cases vary, it is important that a basis for their decision be established by this Court, both for the future guidance of the Commissioner in his determination of deficiencies and as a means of securing their sound disposition by the courts. In the districts in which appeal, if taken, would be to the court below, where the judges are in dis-

[2] See Paul, *Partnerships in Tax Avoidance*, 13 Geo. Wash. L. Rev. 121 (1945).

[3] There are also eleven cases involving $205,000 pending in the district courts.

agreement as to the proper basis of decision,[4] there are 48 family partnership cases now pending.[5] Even now, two such cases (*Lowry* v. *Commissioner* and *Sligh, Jr.* v. *Commissioner*, 3 T. C. 730; *Camfield* v. *Commissioner*, decided February 9, 1944 (1944 P-H T. C. Memorandum Decisions, par. 44,039)) are awaiting decision by the court below. A decision by this Court in the instant case will serve as a basis for resolving pending, as well as future, cases and alleviate the administrative and judicial burdens which the widespread creation of family partnerships is causing.

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be granted.

HAROLD JUDSON,
Acting Solicitor General.

AUGUST, 1945.

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[4] See the dissent of Judge Martin (R. 87–88) and cf. *Lorenz* v. *Commissioner*, 3 T. C. 746, affirmed *per curiam*, 148 F. 2d 527 (C. C. A. 6th).

[5] Of the cases now pending in the Tax Court, 48, involving deficiencies approximately of $961,000 would come within the jurisdiction of the Circuit Court of Appeals for the Sixth Circuit on appeal.

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 317

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

FRANCIS E. TOWER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 10–20) are reported at 3 T. C. 396. The opinion of the Circuit Court of Appeals (R. 60–65) is reported at 148 F. 2d 388.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 2, 1945 (R. 59), and a petition for rehearing was denied on May 14, 1945 (R. 66). The petition for a writ of certiorari was filed on August 13, 1945, and granted on October 8, 1945. (R. 66.) The jurisdiction of this Court

rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1945.

QUESTION PRESENTED

Whether the court below erred in reversing the decision of the Tax Court that the respondent's wife was not a partner with him for purposes of determining his liability for income tax, and that the income attributed to his wife by a partnership agreement was includible in his gross income as defined by Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations are set forth in Appendix A, *infra*.

STATEMENT

The Tax Court found the following facts (R. 11–15):

For 28 years the respondent had been engaged in the business of the R. J. Tower Iron Works, and since the death of his father in 1927, had managed and operated the business. (R. 11.) During the tax years involved, the fiscal years ended July 31, 1940, and July 31, 1941 (R. 10), the business had an average of from 40 to 60 employees, gross assets of approximately $200,000, and an average steel inventory of approximately $50,000. It manufactured sawmill machinery, which was sold through dealers, and metal stamp-

ings, which were sold directly to manufacturers of refrigerators and stoves. (R. 11.)

In September of 1933, the business was incorporated as The R. J. Tower Iron Works, Inc., with 500 shares of capital stock having a par value of $100 each. The respondent received 425 shares; one Amidon, 50 shares; and one Lawrance, 25 shares. The bylaws required that a director of the corporation hold shares of its stock, and all three became directors. The respondent also became president of the corporation, and Amidon became the secretary and treasurer. In the early part of 1934, about six months after formation of the corporation, the respondent purchased the shares of Lawrance, who then severed his connections with the corporation. The respondent's wife was made a director and vice president after the respondent gave her five shares immediately upon purchasing Lawrance's stock. Thereafter the respondent owned 445 shares; his wife, five shares; and Amidon, 50 shares. The ownership of the shares remained the same until August, 1937. (R. 11.)

In July of 1937 it appeared that the corporation had realized substantial profits in that year, and the respondent talked with his wife and Amidon about dissolving the corporation and setting up a partnership. Amidon, who had worked in the business for a long time, kept the books of the company under the respondent's supervision. He had no objection to the formation of

a partnership and believed that the change would not create any great risk as far as he personally was concerned. Consultations were then held with the respondent's attorney and with his accountant, who took care of his tax matters. They were all of the opinion that the formation of a partnership would result in tax savings and eliminate the necessity of filing corporate tax returns. (R. 11–12.)

It was decided that the respondent should transfer stock of the corporation in order that his wife might contribute a substantial share of the partnership capital. On August 25, 1937, he transferred to her 190 shares of his stock. The transfer was recorded on the corporate books and a new stock certificate was issued and delivered to the wife, but the transfer was conditioned upon her placing the corporate assets represented by the stock into the new partnership. The respondent paid a gift tax of $213.44 on the transfer. (R. 12.)

Three days after this transfer, all of the assets and liabilities of the corporation were transferred to a partnership formed under an agreement entered into on the same day between the respondent, his wife and Amidon. (R. 12.) The agreement is reproduced in Appendix B, *infra*, pp. 22–28.

Under the partnership agreement, the business was to be carried on under the firm name of R. J. Tower Iron Works, with the respondent

and Amidon as general partners, and with the wife as a limited partner. The general partners were given exclusive voice in the management and control of the business, and were authorized to determine their own salaries. In case of disagreement, these matters were to be decided by the majority of the general partners in capital interest [the respondent]. The net profits of the business were to be distributed at such times and in such manner as the general partners might agree. (R. 12.)

All partners were to share in the profits in proportion to their respective capital interests, stated to be $81,600 for the respondent, $62,400 for his wife, and $16,000 for Amidon. Losses were to be shared similarly except that the wife was not to be liable in excess of her stated capital interest. The partnership was to continue for a period of 20 years, unless sooner terminated by a decision of a majority of the general partners in capital interest. (R. 12.)

A certificate of limited partnership was filed with the clerk of the county court, and notification of the liquidation of the corporation and the formation of the partnership was given to the banks with which the corporation had transacted business. (R. 12.)

Accounts of the partnership were maintained on a fiscal year ending August 31, and capital accounts were opened on the books showing amounts contributed by each party. Distributive shares of

the profits were credited either to the capital account or to the drawing account of each, and withdrawals were charged to the respective drawing accounts. (R. 13.)

Amidon continued to perform for the partnership the bookkeeping work which he had performed for the corporation. Early in 1938 his responsibilities and duties increased with an increase in business, and respondent and his wife were of the opinion that he should have a larger share in the profits. Accordingly, and on September 1, 1938, his share was increased from 10 percent as stated in the partnership agreement to 25 percent, and the shares of the respondent and his wife decreased, respectively, from 51 percent to 42½ percent and from 39 percent to 32½ percent. This redistribution was agreed on orally; the partnership agreement and certificate on file with the county clerk were not formally amended. The respective capital contributions of the parties remained the same. At the time of the oral agreement for redistribution of the profits, it was also orally agreed that the respondent and Amidon would not in the future take any salaries for their services. (R. 13.)

Although the respondent continued to render to the partnership the same services he had rendered to the corporation, he received no salary after Amidon's share of profits was increased in September of 1938. The partnership carried on

the same business as the corporation, and had the same customers. (R. 15.)

The last return filed by the corporation, for the fiscal year ended August 31, 1937, reported compensation of $11,511.20 paid to the respondent for services rendered as president, and $5,450.44 paid to Amidon as secretary and treasurer. The wife was not actively engaged in the business of the corporation, and received no salary from it. (R. 14.)

The partnership return for the fiscal year ended August 31, 1938, reported a net income of $15,919.85. Of this amount, salaries of $7,761.20 and $3,700.44 were paid to the respondent and Amidon, respectively; and distributive shares of the balance were ascribed to the respondent, Amidon, and the respondent's wife in the respective amounts of $2,273.69, $445.82, and $1,738.70. (R. 13.)

For the fiscal year ended August 31, 1939, the respondent's share of income as shown by the partnership return was $8,710.74; his wife's, $6,661.16; and Amidon's, $5,123.97. The corresponding figures for the following fiscal year were $18,253.51, $13,958.57; and Amidon's, $10,737.36. (R. 14.)

The respondent's wife withdrew $2,032.80 in the fiscal year of the partnership ended August 31, 1939, and $5,000 in the following fiscal year. (R. 13.) Some of the money she placed in her own

savings and checking accounts and some she placed in a box at home to which both she and the respondent had the combination. Since the bank holiday in 1933, the respondent had kept all his money and papers in this safe, although he used a separate box. Before the execution of the partnership agreement, the respondent had given his wife a regular allowance of approximately $75 a week for household expenses. Thereafter, and throughout the taxable years, he continued to give his wife an allowance of $75 a week for household expenses and for her support, although she paid for some of her own clothes. The respondent also paid the expenses of a daughter in college. During the year 1940, the respondent and his wife built and furnished a cottage at Baldwin Lake, the respondent contributing approximately $2,000 and the respondent's wife contributing $3,000. During that year the wife also repaid to him $1,403.88, which represented expenditures made by him for her income tax and certain other expenses. Each paid half the price of a $100 war bond which they purchased each month. (R. 14–15.)

The Tax Court found that since the transfer of the 190 shares to the respondent's wife was conditional, there had been no valid gift thereof to her, and hence that she had not made the capital contribution asserted by the respondent to establish her status as a partner for purposes of the federal income tax. (R. 17–18.) The Tax Court

held that there had been no real partnership between the respondent and his wife for the conduct of a business enterprise, and that the partnership profits credited to her during the tax years involved were taxable to the respondent. (R. 20.)

The Circuit Court of Appeals reversed, holding that the profits credited to the wife's account were not taxable to the respondent, on the grounds that he had made a gift of the 190 shares which became complete on formation of the partnership if not before; and that by contributing the assets of the corporation represented by the shares, she attained the status of a partner. (R. 62–65.)

SPECIFICATION OF ERRORS TO BE URGED

The court below erred in reversing the decision of the Tax Court, to the effect that the respondent was chargeable with the income ascribed to his wife under the so-called partnership arrangement.

ARGUMENT

1. This case, like *Lusthaus* v. *Commissioner*, No. 263, raises the question whether a husband may avoid tax on income derived from a business, attributable both to his personal efforts and his invested capital, by the device of making his wife a "partner" in the enterprise. The applicable principles are discussed in our brief in the *Lusthaus* case, and we respectfully refer the Court thereto for a full statement of our position.

As is shown in that brief, this Court has re-

peatedly held that one may not relieve himself of tax by anticipatory arrangements whereby his earnings or income subject to his control are deflected within the family group. *Lucas* v. *Earl*, 281 U. S. 111; *Burnet* v. *Leininger*, 285 U. S. 136; *Douglas* v. *Willcuts*, 296 U. S. 1; *Helvering* v. *Clifford*, 309 U. S. 331; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579; cf. *Higgins* v. *Smith*, 308 U. S. 473; *Griffiths* v. *Commissioner*, 308 U. S. 355; *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44; *Commissioner* v. *Court Holding Co.*, 324 U. S. 331; *Commissioner* v. *Harmon*, 323 U. S. 44. It is the essence of those decisions that although the arrangement involved may be legally effective under applicable state law, the income nevertheless remains taxable to the assignor, etc., under the Federal statute.

These principles are fully applicable to family partnership cases where the wife in effect brings no new capital or services to the enterprise. The partnership form should have no greater potency than the irrevocable assignment or trust devices that have already been declared ineffective for re-routing tax liability within the family in like circumstances.

Since the Tax Court correctly applied these principles here, it was error for the Circuit Court of Appeals to reverse. Cf. *Dobson* v. *Commissioner*, 320 U. S. 489.

2. The facts disclosed by the record amply

justified the result reached by the Tax Court. The Tax Court found, in accordance with the concession of the respondent (R. 15), that the wife contributed no services to the business; and, furthermore, that she had not made the contribution of capital relied upon by the respondent to establish her status as a partner.

The respondent maintained that his wife had become a partner by contributing to the capital of a partnership, assets of a corporation represented by shares of its capital stock which he had given to her. The corporation had been formed in 1933 to operate an iron works with which the respondent had been engaged for many years, and which he had managed and operated since the death of his father in 1927. (R. 11.) Of the 500 shares of the capital stock of the corporation, the respondent received 425 shares; the bookkeeper Amidon, 50 shares; and one Lawrance, 25 shares. (R. 11.) About six months later the respondent purchased Lawrance's stock, and gave five shares to his wife, apparently to qualify her as a director in the corporation. (R. 11.) When it appeared that the corporation would have considerable profits in 1937, consultations were held with the attorney and the accountant who handled the respondent's tax matters. (R. 11–12.) It was decided that tax savings could be achieved by conducting the business as a partnership, and that the respondent should transfer stock to his wife so that she might contribute a "substantial" share

of the partnership capital.[1] (R. 12.) Accordingly, on August 25, 1937, the respondent transferred to his wife 190 of his 445 shares of stock in the corporation, upon condition that she would place in the partnership the corporate assets which they represented. (R. 12.) The respondent himself testified that the only purpose of the transfer was "to determine her interest in the partnership"; that it was made "solely for this changeover." (R. 38.) The liquidation of the corporation, execution of the partnership agreement, and transfer of the corporate assets and liabilities to the partnership, all occurred on the third day after the transfer of the 190 shares to the wife. (R. 12.)

This evidence certainly provides a rational basis for the finding of the Tax Court that the transfer of the 190 shares of stock to the wife and the transfer of the corporate assets represented by that stock to the partnership were but steps in a larger transaction which did not involve any real contribution of capital by the wife. The court below committed plain error in substituting for

[1] The respondent has in effect conceded that the corporate assets represented by the five shares given to his wife in 1933 could not have amounted to a substantial contribution to the partnership capital. He has not seen fit to argue the dubious factual question (R. 35–36) whether the five shares were owned outright by her and contributed to the capital of the partnership, but has been content to permit his case to turn on the effect of the dealings in the 190 shares.

the finding of the Tax Court its own view that there had been a gift of the 190 shares to the wife, followed by a contribution of her own capital. *Commisioner* v. *Court Holding Co., supra; Dobson* v. *Commissioner, supra; Commissioner* v. *Scottish American Co.*, 323 U. S. 119; *Choate* v. *Commisioner*, 324 U. S. 1; *Wilmington Co.* v. *Helvering*, 316 U. S. 164. In this connection it may be noted that 11 days after it decided the present case, the court below sustained our position on this matter in the substantially similar case of *Lorenz* v. *Commissioner*, 148 F. 2d 527, petition for rehearing denied October 15, 1945.[2]

The Tax Court's valid findings that the wife had made no substantial contribution of capital or services, of themselves required that she be held not to have been a partner within the meaning of Section 181 of the Internal Revenue Code (Appendix A, *infra*). Further circumstances confirm this decision, and provide abundant basis for the additional findings by the Tax Court that as to the wife the partnership arrangement was

[2] While the two decisions are inconsistent, they do not represent inconsistency on the part of any individual judge. Judges Simons and McAllister, who comprised the majority below, did not participate in the *Lorenz* case. Judge Martin dissented below, and in the *Lorenz* case voted with Judges Allen and Hamilton, who did not participate herein. Thus, of the five judges who recently considered this issue in that court, only two, the majority herein, have voted against the Government's position.

but a means of sharing the respondent's earnings from his personal services and his property, and that the withdrawals from profits credited to her represented merely an allocation of income used for the benefit of the family.

The wife was to share in the profits on an equal footing with the respondent and Amidon, although those two were required to devote their full time and energies to the business and were subject to unlimited liability for any losses, while she was not required to contribute any services, and was not liable for losses in excess of her capital interest. (R. 12; Partnership Agreement, par. 5, 13, Appendix B, *infra*, pp. 23–24, 28.) In the words of the Tax Court, this arrangement was "unusual and unreal, especially in view of her limited liability." (R. 20.) On the other hand, the respondent was to have the exclusive voice in the management and control of the business (R. 12; Partnership Agreement, par. 8, Appendix B, *infra*, p. 26); and even power to determine whether, and to what extent, the wife might become entitled to share in the profits, by means of his power under the partnership agreement to fix his own salary in diminution of the profits to be distributed (R. 12; Partnership Agreement, par. 5, 8, Appendix B, *infra*, pp. 23–24, 26). Moreover, her share of the profits was to be distributed at the times and in the manner determined by himself and Amidon, who doubtless would acquiesce with

him.[3] (R. 19; Partnership Agreement, par. 9, Appendix B, *infra*, pp. 26–27.) And for a period of 20 years only the respondent had power to bring about dissolution. (R. 12; Partnership Agreement, par. 2, Appendix B, *infra*, p. 23.)

The unreality of the wife's asserted partnership status, and the true nature of the arrangement as a device for the sharing of the respondent's income, are further shown by what actually occurred during the tax period. The respondent received no salary, although he continued the management and operation of the business, and its profits were in large measure the result of his personal services. (R. 15, 18.) In contrast, the compensation for Amidon's less important services was fixed by increasing to 25 percent his share of the profits, and correspondingly decreasing the shares of the respondent and his wife. (R. 13.) The result of all this was that Amidon's share as a partner during the first year of the partnership which bears on the tax in dispute was approximately the same as the compensation which he had received from the corporation during the last year of its existence, while there was allocated between the respondent and his wife an amount somewhat

[3] Compare the cases holding that appointment of a servile trustee is a significant factor in determining whether the grantor has retained economic ownership. *Central Nat. Bank* v. *Commissioner*, 141 F. 2d 352 (C. C. A. 6th); *Helvering* v. *Elias*, 122 F. 2d 171 (C. C. A. 2d); cf. *Griffiths* v. *Commissioner*, 308 U. S. at pp. 357–358.

greater than the amount received by the respondent as compensation from the corporation during the last year of its existence. (R. 13–14.)

The wife was credited with a share in the business profits on an equal footing with respondent, although she rendered no services to the business. (R. 13–15, 20.) During each fiscal year of the partnership she made substantial withdrawals of business profits, but since she had destroyed the checks reflecting these withdrawals, the purposes for which they had been made could be ascertained only with respect to those made in 1940, which were the greatest in total amount. (R. 13, 20.) It appeared that the greater part thereof had been expended to purchase and furnish a family cottage, and for the purchase of war bonds, together with the respondent; and that all but a small part of the balance had been used to reimburse him for taxes and other expense which he had paid for her. (R. 14–15.) As the Tax Court observed, the former items were of a sort usually defrayed by the husband for the welfare of his family; and "the withdrawals by the wife * * * were merely for the reallocation of income within the family to be used for the benefit of the family." (R. 20.)

It is apparent, then, that the wife became a partner in name and on paper only. The arrangement gave the respondent every significant attribute of control of both income and corpus; he was given exclusive control of the business, and power to

determine the amount, time and manner of the wife's participation in the profits. And as far as could be ascertained by the Tax Court, the profits which he permitted the wife to receive were employed to meet expenses which he himself would normally have incurred for his family. On the record here it is inconceivable that the respondent could have considered himself any poorer after the making of the partnership arrangement. Cf. *Helvering* v. *Clifford*, *supra*, pp. 335–336. Plainly the Tax Court was not bound as a matter of law to accord tax consequences to this arrangement. *Mead* v. *Commissioner*, 131 F. 2d 323 (C. C. A. 5th), certiorari denied, 318 U. S. 777; *Lorenz* v. *Commissioner*, *supra*; *Doll* v. *Commissioner*, 149 F. 2d 239 (C. C. A. 8th), certiorari denied October 8, 1945; *Miller* v. *Commissioner*, 150 F. 2d 823 (C. C. A. 2d); *Grant* v. *Commissioner*, 150 F. 2d 915 (C. C. A. 10th); *Bradshaw* v. *Commissioner*, 150 F. 2d 918 (C. C. A. 10th); *Commissioner* v. *Court Holding Co.*, *supra*; *Helvering* v. *Clifford*, *supra*, p. 336.

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[1] In the *Miller* case the Circuit Court of Appeals said of a family partnership arrangement predicated upon a gift of capital (p. 824):

"* * * the completeness with which the forms were observed is of no significance, for it is precisely what we should expect, if they were to be only forms. * * * Unless we must allow ourselves to be fobbed off by an elaborate documentary paraphernalia, because it is completely carried out, it is impossible to upset the finding. Indeed, it shows a curious trust in the efficacy of the written word, that the appeal should have gone beyond the Tax Court."

CONCLUSION

The decision below is erroneous and should be reversed.

Respectfully submitted.

J. HOWARD MCGRATH,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
ARNOLD RAUM,
HELEN R. CARLOSS,
JOHN F. COSTELLOE,
Special Assistants to the Attorney General.

DECEMBER 1945.

APPENDIX A

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *. (26 U. S. C. 11.)

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *. (26 U. S. C. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. (26 U. S. C. Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the

partnership, computed as provided in section 183 (b). (26 U. S. C. 182.)

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) *General rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c). (26 U. S. C. 183.)

SEC. 188. DIFFERENT TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner. (26 U. S. C. 188.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 3797)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined. * * *

APPENDIX B

LIMITED PARTNERSHIP AGREEMENT OF R. J. TOWER IRON WORKS[1]

THIS AGREEMENT made as of the 28th day of August, 1937, by and between Francis E. Tower, Harvey A. Amidon and Hazel I. Tower, witnesseth:

WHEREAS, the parties hereto were all of the stockholders of a corporation heretofore existing and known as R. J. Tower Iron Works, a Michigan corporation, the term of existence of which expires on August 30, 1937; and whereas the parties desire and intend to carry on and continue the business in which said corporation was engaged, taking over all of the assets of said corporation subject to its indebtedness, and form a limited partnership to that end and for that purpose;

NOW, THEREFORE, IT IS HEREBY AGREED that a limited partnership shall be and is being formed by the parties hereto in accordance with the terms of this agreement.

1. The name and style of said limited partnership shall be R. J. Tower Iron Works. Its place of business shall be Greenville, Montcalm County, Michigan, and it will carry on the business of a general foundry and machine shop, the manufac-

[1] This partnership agreement was introduced as Exhibit 8 in the proceedings before the Tax Court. (R. 23.) The Circuit Court of Appeals ordered (R. 56-57) that the exhibits so introduced need not be fully set forth in the transcript to be certified by the Tax Court, but might be transmitted to the Circuit Court of Appeals, and that either party would have the right to print as an appendix to his brief such portions of any of the exhibits as he might see fit.

turing and selling of sawmill machinery, road machinery, stampings of steel and articles composed of metal and wood, or metal or wood alone, and any business incidental thereto.

2. The partnership shall exist for the term of twenty years unless sooner terminated, as it may be by a decision of a majority in interest of the partnership capital, including the capital interest of limited and the assignees of limited partners. If the termination of the partnership is so decided upon, the partners so deciding shall give notice of their decision to the remaining partners, and offer their interests in the partnership for sale under and pursuant to the provisions of other paragraphs of this agreement.

3. The said Francis E. Tower and Harvey A. Amidon shall be general partners and the said Hazel I. Tower shall be a limited partner.

4. The capital of the partnership shall be represented by and shall consist of all of the assets and business of said former corporation, the R. J. Tower Iron Works; all of which assets and business are to be this day conveyed, assigned and transferred by said corporation to said partnership at their fair value subject to the liabilities of such corporation, which liabilities this partnership assumes, and the amount contributed by each of said partners as his or her proportionate share of such assets and business is as follows:

Francis E. Tower	$81,600.00
Harvey A. Amidon	16,000.00
Hazel I. Tower	62,400.00

5. Each of the partners shall receive, by reason of his or her contribution, such share of the profits of the partnership business, and shall bear such share of the losses as his or her aforesaid con-

tribution to the partnership capital bears to the total partnership capital aforesaid, and the interest in and share of each partner, both general and limited, in the partnership capital shall at all times be the same proportionate share thereof whether the partnership capital hereafter increases or diminishes in amount or value as a result of business operations. The limited partner shall, in no event, be liable for or subject to any loss or losses whatsoever in excess of the amount of the capital contributed by her to the capital of the partnership. Nothing herein contained is intended to prevent the payment of salaries and bonuses to the general partners for services to be rendered by them in the active *man-agreement* [sic] of the business of the partnership, such salaries and bonuses to be deducted from the earnings of the partnership before the profits available for distribution to all of the partners are determined.

6. The partnership shall cease in the event of the death, retirement or incapacity to act of any partner. If at any time any limited partner desires to sell his or her interest in the partnership business and property, such partner shall first offer the same to the remaining limited partner or partners, if any, and if they do not desire to buy the same may be sold at will. If they or any of them desire to buy and the price to be paid cannot be agreed upon, the same shall be fixed by three appraisers, one chosen by the retiring partner, one by the remaining partners, and the third by the two so selected. If none of the remaining partners is satisfied to pay the price so fixed, the retiring partner may sell at will to any person, who upon purchasing, shall

become a limited but not a general partner. These conditions shall also apply to and govern the sale of the interest of any deceased or incapacitated limited partner by his or her executor, administrator, trustee, guardian or heir or heirs. In case of the death, retirement or incapacity to act of a general partner, the remaining general partners shall continue the business until such time as the interest of the said general partner can be determined. Such interest may then be withdrawn, or it may then be treated as the interest of a limited partner, on such terms and in such manner as may be agreed upon between such general partner, his estate and the remaining general and limited partners.

7. If the interest of any general partner be sold to a stranger to the partnership, the purchaser shall become a general partner in the retiring partner's place and stead if all of the remaining partners so agree, otherwise his status shall be that of a limited partner under the provisions of the Uniform Limited Partnership Act. If the sale be to a general partner or partners, such interest shall be added to and become a part of his general partnership interest in a share of the partnership assets and business. If the sale be to a limited partner or partners, the purchaser or purchasers shall become a general partner or partners only to the extent of the interest so purchased. If the interest of any limited partner be sold to a general partner or partners, the purchaser or purchasers shall become a limited partner to the extent of the interest so purchased unless the general partners otherwise agree. No general partner shall be permitted to sell his

interest in the partnership unless an arrangement satisfactory to other general partners and to creditors is made covering liability for obligations of the partnership then existing.

8. The general partners shall manage, control and direct the partnership business and affairs, including the determination of the salaries to be paid to each for his services, and such salaries shall be a part of the expenses of operating the business, and no part thereof shall be charged against the "capital" or "profits" accounts of any of such partners. The general partners shall advise with each other in all things pertaining to any business policy, the purchase and sale of any business property, the making of business contracts, the borrowing of money and the signing of promissory notes and other evidences of indebtedness. All contracts, conveyances, notes, checks, drafts, etc., are to be signed by such partner or partners as the majority shall direct. If the majority of the general partners shall be unable to agree, or because of the number of partners no majority is available, then in connection with the matter in controversy the decision shall be controlled by the majority in capital interest of the general partners.

9. The fiscal year of the partnership hereby organized shall end on August 31st of each year. At the end of each fiscal year a general account of the partnership business shall be taken and a report thereof made by the general partners each to the other and to the limited partners. The net profits for each year shall be distributed at such times and in such manner as may be determined upon by the general partners, havin-

in mind the necessities and success of future operations of the business. The general partners may make advancements to any partner on account of his or her share of the profits earned pending the next general accounting and distribution. The annual general accounts or accounting of the partnership shall contain in detail such information as is necessary fully to advise every partner with reference to the affairs of the business and its financial condition.

10. If at any time during the continuance of the partnership, or upon the termination thereof, any dispute, question or difference shall arise between the partners, or any of them, or their representatives, touching the partnership, its accounts or transactions, or its dissolution or winding up, or the construction, meaning or effect of this agreement or otherwise in relation to the premises, then every such dispute shall be referred to the arbitration of three disinterested persons, one to be chosen by each party to the dispute and the third by the two so chosen, and if either party shall neglect or refuse to appoint an arbitrator within fifteen days after the other party shall have made his selection and given notice thereof, then the arbitrator appointed as aforesaid shall, at the request of the party appointing him, proceed to hear and determine the matters in difference as though he were an arbitrator appointed by both parties for the purpose, and the award or determination which shall be made by the said arbitrator or arbitrators shall be final and binding on their respective executors, administrators and assigns.

11. Upon the termination or dissolution of the

partnership, full account of the assets and liabilities of the partnership shall be taken. The assets shall be liquidated as promptly as possible and the proceeds thereof shall be applied as follows:

(a) The payment of the debts and liabilities of the partnership and expenses of the liquidation.

(b) The repayment of the capital contributed by the general and limited partners, or such portion thereof as can be paid out of the assets of the partnership then remaining.

(c) The surplus of any of such assets remaining shall be divided among the partners according to their respective interests therein as herein defined.

13. Each general partner further covenants to give his whole time and attention to the business of the partnership and to use his utmost exertion to promote its success, and that he will not during the continuance of his partnership engage or be interested in any other business whatsoever to an extent that will be detrimental to the best interests of the partnership.

14. If at any time during the continuance of the partnership all of the parties hereto shall desire to change or amend this agreement, they may do so by attaching thereto such supplemental agreement as they may wish to make, the same to be signed by all of the parties hereto, and the same then to become effective as if originally incorporated herein.

IN WITNESS WHEREOF, the parties hereto have executed four original copies of this agreement.

FRANCIS E. TOWER,
HARVEY A. AMIDON,
HAZEL I. TOWER.

U. S. GOVERNMENT PRINTING OFF 1945

FILE COPY

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1945

No. 317

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

FRANCIS E. TOWER.

BRIEF OF TAXPAYER IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

OSCAR E. WEBB,
Attorney for Taxpayer,
Business Address:
1107 Peoples Nat'l Bk. Bldg.,
Grand Rapids, Michigan.

AMERICAN BRIEF AND RECORD CO., GRAND RAPIDS, MICHIGAN

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THE FACTS

The Tax Court made findings of fact on which we relied in the Circuit Court of Appeals. The Commissioner's petition sets forth most of the facts found by the Tax Court, but it omits one essential factor, viz., findings by the Tax Court that the partnership enterprise had gross assets used in the business of approximately $200,000; had an average steel inventory of approximately $50,000 and employed from 40 to 60 people (R. p. 16). These omitted facts and findings are important as showing that the partnership employed a very substantial capital in the production of income, as distinguished from a family partnership where the earnings result from the individual efforts of the husband.

REASONS FOR DENYING THE WRIT

The petition should be denied because:

1. It fails to bring up for review any specific legal question.
2. The decision in this case is not in conflict with any decision of any other Circuit Court of Appeals.
3. The decision in this case is not in conflict with any decision of, or legal principle laid down by, this Court.
4. This case was correctly decided by the Circuit Court of Appeals for the Sixth Circuit.

I.

No Specific Legal Question is Submitted For Review

A petition for writ of certiorari, if entitled to serious consideration, should bring up for review some specific and definite legal question. The petition before us fails to do so, and fails to meet the requirements of Rule 38 (5b) of this Court.

The Commissioner, on page 2 of his petition, states the "question presented" as being:

> "Whether the Circuit Court of Appeals erred in reversing the Tax Court's decision that there was not in substance a contribution of capital to the business by taxpayer's wife and no real partnership between them, and that taxpayer earned the partnership profits credited to the wife's account.

This presents no specific legal question except as to whether in this particular case there was any substantial basis in the evidence to warrant the Tax Court's conclusions. And it presents no "conflict among the Circuits, or constitutional questions, or a clear cut mistake of law of real importance," which this Court has recently laid down as the requisites for review by this Court (*Bingham Comm.* June 4, 1945, Adv. Op. Vol. 89, No. 16, p. 1191).

The provisions of the Revenue Code and Regulations set forth by counsel (Pet. 2, 3) are not here, and were not before the lower courts, in controversy. No one in this case has yet questioned their meaning, or their applicability.

No one has questioned the facts found by the Tax Court. We adopted the Tax Court's findings of fact in the Circuit Court of Appeals, and based our entire appeal on those findings. On the basis of those findings (and on the basis of anything else which can be found in the record) "there was no warrant in the record" (*Dobson v. Comm.*, 320 U. S. 489; *Bingham's Trust v. Comm.*, June 4, 1945, 89 Adv. Op., p. 1191), and there was not "substantial basis in the evidence" (*Commissioner v. Scottish Am. Co.*, 323 U. S. 119) to support the Tax Court's Conclusions. The Circuit Court of Appeals was therefore called upon to reverse, and it did reverse, the Tax Court.

Surely counsel do not ask this Court to establish a new principle of law and one contrary to the present Revenue Laws which permit (and under the gift and estate tax laws encourage) husbands to make gifts to their wives, and which permit persons, including husbands and wives, to carry on business under various legal entities, including limited partnerships, general partnerships, corporations, and unincorporated associations. And, surely, Counsel do not ask this Court to hold that in any case involving a gift from a husband to a wife, or involving a partnership in which a husband and wife are members, the Tax Court can, *regardless of the facts*, preclude a review by an appellate court merely by making a final finding, not based on evidence, that a gift was not bona fide and complete, that the husband retained the economic benefits of that gift, that a partnership was not bona fide, or that the husband — and not capital — earned the income.

It is only on such theories that the decision in the instant case is subject to reversal — theories which have already been expressly repudiated by this Court in the

recent case of *Bingham's Trust v. Comm.* (June 4, 1945) supra, in which this Court said:

> "Hence the statute does not leave the Tax Court as the final arbiter of the issue whether its own decisions of questions of law are right or wrong. That can only be ascertained upon resort to the prescribed appellate process by a consideration of the merits of the point of law involved, and by its decision at the conclusion of the process, not before it begins. The fact that the Court of Appeals below, while accepting the Tax Court's findings of fact, has nevertheless reversed its decision, would seem not to leave the question of law decided so free from doubt that the mandate of the statute could rightly be disregarded on any theory. If review were to be denied in this case, it would be difficult to say that any construction of a taxing statute by the Tax Court would be subject to appellate review."

In the instant case, the Circuit Court of Appeals properly reversed the Tax Court for its error of law in arriving at conclusions having no substantial basis in the evidence.

To reverse the instant case, this Court would have to find that there was "warrant in the record" (*Dobson v. Comm.*, 320 U. S. 489) to sustain the decision of the Tax Court, or it would have to find that there was a "substantial basis in the evidence" to support the Tax Court's conclusions (*Commissioner v. Scottish Am. Co.*, 323 U. S. 119). These findings would have to be predicated on evidence *in the instant case* and not in some other case or cases claimed by the Commissioner to be now pending. A decision by this Court in the instant case would therefore be no guide and would not be controlling in any other case.

Instant Case Not Controlling In Any Other Case

The Commissioner claims that the instant case involves "complex questions" which are not present in the Doll case (Pet. 13, footnote); that there are now pending in

the various courts 280 cases involving more than $5,000,000 in taxes (Pet. 18, 19); and that a decision by this Court in the instant case will "serve as a basis for resolving pending, as well as future, cases and alleviate the administrative and judicial burdens which the widespread creation of family partnerships is causing" (Pet. 19).

The Commissioner must be using language employed by him in some other case involving grave constitutional questions or fundamental principles in the law of taxation. He fails to point out what are the "complex questions", or in what possible way a decision in the instant case can possibly be a basis for decisions in any pending or future cases. The most casual reading of the Tax Court's Findings of Fact and the opinions of the Tax Court and of the Circuit Court of Appeals will make it apparent that a decision by this Court in the instant case will be of no value in any other case because the instant case depends on its own peculiar facts.

The Commissioner has failed to point out any question of law, either simple or complex, new or old, on which different Circuit Courts of Appeal have come to different conclusions or which is involved in any other case now pending, the solution of which the Commissioner claims would be easy if the present case were reviewed.

The Commissioner tries to make it appear that the "question presented" is of general importance because of the considerable number of partnership cases now pending before the courts. It might be argued with equal logic that every case involving corporations, or involving trusts, or involving gifts, should be reviewed by this Court because of the large number of cases which fall within these general categories. It was recognized both by the Court below, in its opinion in the instant case, and by the Tax Court in the recent decisions in *Davis B. Thornton*, 5 Tax Court No. 13 (May 22, 1945), that each family partnership case depends on its own facts, such as the completeness of the prior gift of corporate shares, the provisions of the partnership agreement covering the wife's control over her share, whether the partnership involved merely personal services of a particular partner or whether

capital was an important income producing factor, whether the books of account were regularly maintained on a partnership basis, and whether her distributive shares of the profits were actually credited and made available to the wife free from the domination or control of the husband.

The Commissioner has failed to show in any way that any of the various family partnership cases now in litigation involve facts or questions similar to those in the instant case. If they were similar, they would still have to be decided on their own facts, and in line with legal principles already established by this Court in the Dobson, Scottish American, and Bingham cases, and in line with established legal principles (not here in dispute) as to what constitutes a valid gift and a valid partnership for tax purposes.

If Instant Case Calls for Review, All Cases Call for Review

If this Court is called upon to pass upon the only question here involved, viz., was there "warrant in the record", or "substantial basis in the evidence" to sustain the decision of the Tax Court, then, in fairness to other taxpayers, as well as in fairness to the Commissioner, this Court should review all of the 280 partnership cases now claimed to be pending because each and every one of these cases, while involving the same admitted legal principles of "warrant in the record" and "substantial basis in the evidence" will depend for its solution on its own particular facts.

II.

Decision in Tower Case Not in Conflict with Decisions in Other Circuits

It is elementary that "out of the facts the law arises, and the facts, together with the law, bring forth the right."

The instant case involves the validity of a gift and of a limited partnership organized under the Michigan law. There has at no time been a disagreement between counsel or between counsel and the lower courts as to the legal requirements of a gift or a limited partnership. The only question here involved has been and is whether under the undisputed facts as found by the Tax Court (and as found in the record), the legal requirements have been fully met, and whether there was any substantial basis in the evidence that, notwithstanding the fullfillment of legal requirements, either the gift or the partnership were a mere sham so that the substance, rather than the form, of the transaction viewed as a whole, constituted what would, in effect, be a tax fraud, something which, by the way, the Commissioner never charged nor attempted to prove.

The Commissioner claims that the decision in the Tower case is in conflict with the decisions in family partnership cases from other circuits. There is no conflict as far as any principle of law is concerned. The cases from other circuits in which family partnerships were not sustained involved different facts, on the basis of which facts a different conclusion was reached. In all of such cases the Circuit Court of Appeals found that the findings of the Tax Court had "warrant in the record", or had "substantial basis in the evidence", as required by the Dobson, Scottish American and Bingham cases.

The Commissioner claims (Pet. 10-12) that in nine cases the decisions in other circuits conflict with the decision in the instant case.

Five of these cases (*Earp v. Jones*, 131 Fed. (2d) 292; *Mead v. Commissioner*, 131 Fed. (2d) 323; *Waldburger v. Helvering*, 131 Fed. (2d) 598; *Tinkoff v. Commissioner*, 120 Fed. (2d) 564, and *Doll v. Commissioner*, 149 Fed. (2d) 239) involved income resulting from *personal services* (as distinguished from capital) such as salesmen's and insurance commissions, accountant's fees, etc. It has consistently been held, and rightly so, that a man cannot make future return of income from his own personal services taxable to his wife or anyone else (*Lucas v. Earl*, 281 U.S. 111; *Burnet v. Leininger*, 285 U.S. 136; *Helvering v. Eubank*, 311 U.S. 122).

The other four cases are clearly different in their facts from the instant case.

In *Lusthaus v. Commissioner*, 149 Fed. (2d) 232, the Circuit Court for the Second Circuit found (though there was a strong dissenting opinion) that there was "substantial evidence" to support the Tax Court's conclusions, in that "it could be inferred from the evidence, there was no real contribution of capital by the wife". As the Court pointed out, the Tax Court had found, as facts, that both the purported sale from the taxpayer to his wife of an interest in the business, and the organization of the purported partnership, were not effective until approximately the middle of the taxable year involved (1940) although ante-dated to the beginning of the year; that the wife's contribution of capital consisted solely of a check for $50,253.81 and eleven promissory notes made payable to her husband in $5000.00 annual installments over an eleven year period; that the check of the wife was delivered to her husband shortly after she had received a check from him in the amount of $50,000; and that until "some time in 1940" the husband and wife had maintained a joint bank account. Primarily on the basis of these findings, which the taxpayer's attorney conceded to be substantially correct, the majority of the reviewing court held that "the circumstances surrounding the $50,000 incident, with the money immediately returned to the petitioner, could be construed as indicating that the latter had not divested himself irrevocably of the subject matter of the gift." Moreover, the Tax Court found that during the taxable year involved the husband had withdrawn $4604.76 from the business as against $59.61 withdrawn by the wife, and the husband had continued to file social security tax returns as owner of the business.

In the Grant and Strong cases (July 19, 1945 Prentice-Hall 1945 Par. 72,626) the wives returned to the partnership all distributions except the portions necessary to pay income taxes on them; the distributions were placed in joint bank accounts with the husbands so that the latter retained control of them; the husbands continued to do business as "Strong & Grant, a copartnership consisting of Ernest A. Strong and Joseph W. Grant acting as joint

contractors and co-adventurers", and under the partnership agreements, the wives' interests were subject to be sold without their having any choice in fixing or obtaining a fair purchase price. It was properly held that the husbands continued to control and enjoy "the same economic benefits they would have realized had they retained unqualified ownership of such assets and income."

In *Argo v. Commissioner* (C. C. A. 5th — June 20, 1945 — Prentice-Hall, Par. 72,588) the partnership arrangement was purely oral; there was no deed, bill of sale or any other written form of conveyance transferring any interest to the wife and minor children, in statements to his bank and in paying taxes the husband designated himself as the owner of the business, and there was evidence that the earnings of the husband were approximately 50% of the physical assets of the business so that capital was not the major income producing factor.

It may also be mentioned, in passing, that the Circuit Courts of Appeal, in deciding the Grant, Strong and Argo cases, did not even deem it necessary to mention, though they must have been cognizant of, the instant case decided April 2, 1945.

The Tax Court itself (Judge Harron dissenting) has distinguished cases like *Earp v. Jones* and *Mead v. Commissioner*, supra, on the ground that they involve personal service businesses, the income from which is attributable to the persons rendering the services. (*M. W. Smith, Jr.*, 3 *Tax Court*, 894, 905; *Robert B. Scherer*, 3 *Tax Court*, 776, 793; *J. D. Johnson, Jr.*, 3 *Tax Court*, 799, 809).

In the recent case of *Davis P. Thornton*, 5 Tax Court, No. 13, the Tax Court (Judge Harron again dissenting) gave consideration to the decision of the Circuit Court of Appeals in the instant case and found no difficulty in distinguishing the Lusthaus and Mead cases (cited by the Commissioner as creating a conflict) from the instant case. The Tax Court also reaffirmed the right of a husband to make a gift to his wife even if it is done for the purpose of saving taxes, by saying:

> "No case, we think, goes so far as to deny the right to make gifts of property, even though the re-

sult is a division of income in accordance with ownership thereof. Helvering v. Horst, 311 U. S. 112. The right to make gifts of one's property is no attenuated subtlety. * * * Mere purpose to avoid tax does not in itself vitiate a transfer of property."

III.

Instant Case Not In Conflict With Decisions Of This Court

Petitioner claims that "the decision of the court below conflicts in principle with decisions of this Court on related issues" viz.: that ownership for tax purposes is not circumscribed by refinements of legal title; that taxation is concerned with economic realities; that command over or enjoyment of property marks the real owner for tax purposes; that tax consequences flow from substance rather than form; that a legal entity which is a sham may be disregarded; that he who earns the income cannot escape taxation by procurring payment to another; that the Tax Court is entitled to view separate steps as a whole; and that the Tax Court's conclusion as to the substance of a transaction is conclusive if supported by evidence (Petition 13-15). We have at no time disputed any of these principles. We agree with them, and the Circuit Court of Appeals followed them. But there was no warrant in law and no substantial basis in the evidence, in the light of such tests, to justify the Tax Court's decision.

The Commissioner would not enumerate all these general and well known rules if he really had some specific legal principle on which he could rely, and on which he sought review.

The nearest counsel come to being specific is when, in their petition, they say:

> "The decision, below, contrary to the principle laid down by this Court in Dobson v. Commissioner, fails to give effect to findings of the Tax Court which make it clear that taxpayer controlled the distribution of partnership income to his wife. It is clear that tax-

payer could determine the time for and manner of disposition of partnership profits for, as the Tax Court found under the partnership agreement, taxpayer and Amidon (the third partner) were authorized to make these determinations and taxpayer's decision controlled if they failed to agree, since he was the majority of the general partners in capital interest. Other findings of the Tax Court reflecting taxpayer's complete control of the business make it apparent that the production of partnership income depended upon his will. In a real sense, therefore, the partnership earnings were subject to his disposition" (Petition, page 17).

The taxpayer's control of salaries and the distribution of partnership profits was in accordance with the Michigan Uniform Limited Partnership Law which entrusts the active management of such a partnership to the general partners by expressly providing in Sec. 4 that "The contributions of a limited partner may be cash or property, *but not services.*" (Michigan Uniform Limited Partnership Act; Par. 20.54 Mich. Stats. Anno.) And the husband's control over the partnership interest of his wife was no different than it would have been if the wife had been a total stranger. His control was also no different than is the control exercised by a majority stockholder in a corporation, through his elected board of directors, over the payment of salaries and the distribution of dividends.

The husband, as the controlling general partner, did have control of the management of the partnership business, but that control did not at any time, nor in any way, give him the right to divert to himself one cent of the wife's capital interest or of the share of earnings which, under the partnership agreement, belonged to the wife. And he never did divert either one cent of that capital or of those earnings to himself. She withdrew substantial portions of her earnings, and the portion of her earnings which were not withdrawn but which were left in the business, were at no time available to her husband. They were available, as were the undrawn earnings of the husband, as working capital, to carry on the business for the bene-

fit of all the partners, with the husband having and exercising no authority whatever to divert or in any way obtain for himself the economic benefits of the wife's share.

The Tax Court has held that such limited partnerships, as between husband and wife, are entitled to full recognition for tax purposes, and the Commissioner of Internal Revenue has announced that he acquiesces in such decisions. (*Glensder Textile Co.*, 46 B.T.A., 176; Acquiescence 1942 — 1 cum. Bul., p. 8) To same effect see *Sidney Nathan, et al.*, T. C. Memo. of May 14, 1943; *Taywall, Ltd.*, T. C. Memo. Op. of July 20, 1942.

We challenged government counsel in the Circuit Court of Appeals to find anything in the testimony anywhere (or in the Tax Court's Findings of Fact) which bears out the statements of Judge Harron of the Tax Court that:

> "petitioner did not intend to make a gift of the stock he did not intend to divest himself of such title, dominion and control of the stock as was necessary to constitute a good and valid gift thereof in praesenti, the transfer was not such that the entire dominion and control of the gift was in the wife" (R. 23), and the husband was "the person who earned the income which was credited to the wife's account" (R. 28).

Counsel did not meet, and made no attempt to meet, this challenge, though we made it in our briefs and on the oral argument before the Circuit Court of Appeals. When counsel failed to meet the challenge, we challenged the Circuit Court of Appeals to find anything in the record anywhere which would bear out Judge Harron's statement or from which an inference could be drawn that there was any "warrant in law" or "substantial basis in the evidence" to support the Tax Court. It will be noted that Judge Martin, in his dissenting opinion in the instant case (R. 87), did not meet, and did not attempt to meet, this challenge.

Conflict of Decisions, if one exists, is in Tax Court

The only conflict we have been able to find in husband and wife partnership cases is that which appears in the varying views of the sixteen members of the Tax Court itself, expressed, for instance, in six different opinions in the recent case of *Camiel Thorrez*, (May 21, 1945), 5 Tax Court No. 8.

Since the Tower case was decided, the Tax Court, in cases depending on their own facts but not varying greatly from the facts in the instant case, has sustained husband and wife partnerships:

Robert P. Scherer, 3 Tax Court 776;
J. D. Johnston, Jr., 3 Tax Court 799;
Felix Zukaitis, 3 Tax Court 814;
M. W. Smith, Jr., 3 Tax Court 894;
Davis B. Thornton, 5 Tax Court No. 13.

The instant case was heard and decided by Judge Harron of the Tax Court, without review by the whole court. Since the instant case was decided, the five cases above cited have all been decided in favor of the taxpayer, after review by the whole Court, Judge Harron in each case dissenting. In all except the Thornton case, only recently decided, the Commissioner has announced his acquiescence, thus showing that there is no novel question of law presented but merely a matter of applying admitted legal principles to the facts of each case.

Weight of Tax Court Decisions

This Court, in the Dobson case, has referred to decisions of the Tax Court as being "characterized by substantial uniformity", and as being entitled to great weight and not subject to review if they have "warrant in the record" and "a reasonable basis in law". This Court has also said in concurring opinion in the more recent Bingham's Trust case that while "the interpretation of tax statutes and their application to particular circumstances are all matters peculiarly within the competence of the Tax Court, on the other hand, constitution-

al adjudication, determination of local law questions and common law rules of property such as the meaning of a general power of appointment, or the application of the rule against perpetuities, are outside the special province of the Tax Court."

There might well have been included in the latter category questions of what constitutes a gift, a limited partnership, or what constitutes the beneficial use, as distinguished from the ownership, of the legal title to real or personal property. These, too, involve common law rules of property, and they involve no "interpretation of tax statutes." As we have already indicated, the provisions of the Revenue Code and Regulations set forth on pages 2 and 3 of the petition are not here, and were not before the Tax Court or the Circuit Court of Appeals, in any way in controversy. No one in this case has ever questioned either their meaning or their applicability.

IV.

The Instant Case Was Correctly Decided By The Circuit Court of Appeals

The Tax Court based its decision in the instant case on the conclusion: (1) that the gift of the corporate stock to the wife was not valid and complete as the result of which she made no capital contribution to the partnership and she was therefore not a bona fide partner; (2) that the dissolution of the corporation and the formation of the partnership fulfilled no business purpose other than the saving of taxes to petitioner (R. 25); (3) that there was no real partnership between the husband and wife for the conduct of a business enterprise; and (4) that petitioner was the person who earned the income which was credited to the wife's account (R. 28).

Petitioner refers to the foregoing as "findings" (Pet. 18). They are, however, merely ultimate conclusions, for which there is no substantial basis in the evidence, or in the specific Findings of Fact.

Out of the facts the law arises, — and in the instant case (1) the facts were undisputed: (2) the facts were found by the Tax Court in its specific findings of fact; (3) we relied and now rely on those findings; and (4) we contend that on the basis of those findings of fact there is no "warrant in the record" and there is not "substantial basis in the evidence" to support the Tax Court's conclusions.

No one, either counsel or court, has yet been able or has even attempted to point out anything anywhere in the findings of fact, *or in the record in this case,* from which an inference can be drawn that the gift was not complete and bona fide, that the partnership was not legally organized and carried on in absolute good faith, that the husband retained the economic benefit of that which he gave to his wife, or that her share of the partnership profits were not derived from the use of capital but were the result of her husband's individual efforts.

We suggest that the Judges of this Court, in their consideration of the petition for certiorari, read the Tax Court's findings of fact (R. 15), the Tax Court's opinion (R. 21), and the opinions of the Circuit Court of Appeals (R. 82). Nothing further should be needed to convince this Court that this case has now been correctly decided and that a further review is unnecessary.

Respectfully submitted,

OSCAR E. WAER,
Attorney for Taxpayer.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1945

No. 317

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

FRANCIS E. TOWER.

BRIEF FOR TAXPAYER AND RESPONDENT

OSCAR E. WAER,
Attorney for Taxpayer and Respondent.
Business Address:
1107 Peoples Nat'l Bk. Bldg.,
Grand Rapids, Michigan.

AMERICAN BRIEF AND RECORD CO., GRAND RAPIDS, MICHIGAN

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No. 317

COMMISSIONER OF INTERNAL REVENUE,
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FRANCIS E. TOWER.

BRIEF FOR TAXPAYER AND RESPONDENT

PETITIONER'S STATEMENT OF FACTS

(In the following brief, references to pages of the Transcript are indicated as T. 2 and references to Petitioner's brief are indicated as B. 2, etc.)

The Tax Court made Findings of Fact which state concisely the undisputed facts in this case. There were no disputed facts. We adopted those Findings in the Circuit Court of Appeals as our Statement of Facts, and relied upon them. We are willing to rely on them here. Petitioner, instead of being satisfied with them, has attempted to restate them, in some instances confusing them. Petitioner has also, in his argument, stated as facts what are merely conclusions found in the Tax Court's opinion (not Findings of Fact) and by which it attempted to justify its decision.

We suggest that this Court treat the Tax Court's Findings of Fact as being a full and fair statement of the facts (T. 10-15).

Petitioner's statement of facts should be amended or corrected, as indicated by the following:

The 190 shares of stock transferred by the taxpayer to his wife as a gift on March 15, 1938, were valued, for gift tax purposes, at $57,114.60 (T. 12). The wife had, since 1935, owned 5 shares of stock (T. 11), making her ownership 195 shares, and her resulting contribution to the capital of the partnership $62,400 as against her husband's contribution of $81,600 and Amidon's contribution of $16,000 (T. 12).

The partnership agreement covered the carrying on of a business theretofore handled by the corporation, viz.: the business of a general foundry and machine shop, and the manufacture and sale of sawmill and road machinery and wood and metal stampings (B. 22).

The partnership agreement provided for the termination of the partnership on the death, retirement or incapacity of any partner, general or limited (B. 24). It provided, also, that a limited partner could sell his interest at will the price to be determined by three appraisers chosen in the usual way, though the remaining limited partners, if any, had the first right to buy (B. 24).

While the general partners had the right to determine the time and manner of distribution of net profits for each year, they were required to "have in mind the necessities and success of future operations of the business" (B. 26, 27). Differences between the partners, if not amicably adjusted, had to be submitted to disinterested arbitrators (B. 27).

In the fiscal years ending August 31 of the years 1938, 1939 and 1940, the withdrawals of earnings by the three partners were as follows (T. 13):

	1938	1939	1940
Mr. Tower	$5,394.74	$10,458.38	$4,973.25
Mr. Amidon	938.96	4,410.18	5,183.08
Mrs. Tower	4,311.66	2,032.80	5,000.00

Petitioner states as a fact that the "profits of the business were in large measure the result of taxpayer's personal services" (B. 15). His reference is to the opinion (not the Findings of Facts) of the Tax Court (T. 18). There is no basis in the evidence for this conclusion, the business not being a personal service enterprise but being a manufacturing enterprise having an average of from 40 to 60 employees and gross assets of approximately $200,000 (T. 11). The taxpayer was the operating head of the business (T. 10).

Petitioner states that the wife became a partner in name and on paper only (B. 16). She had the record title (as shown by the records in the office of the County Clerk) to a 39% interest (later 32½) in the partnership business (Appendix, this brief, Article VI Partnership Certificate), which she had a right to sell at will (B. 24), and which at her death would go to her heirs or legatees (B. 24).

THE APPLICABLE LAW

The Petitioner, in his brief in the instant case (and in the Lusthaus case) recites general principles of law heretofore laid down or recognized by this Court, viz.: that an anticipatory assignment of income to be earned in the future is, from the tax standpoint, ineffective; that an otherwise legally perfect gift of property, but unaccompanied by its economic benefits, does not relieve the donor of the tax on future income; that the income tax law is not so much concerned with refinements of title as with the actual command over the income; that mere formal passage of title alone is not sufficient, especially where family partnerships are involved; that for tax purposes enjoyment of economic benefits marks the real owner; that intra-family transactions should be closely scrutinized to determine whether they are real or sham; and that income from personal services is taxable to him who earns it.

We have at no time disputed any of these principles. We agree with them, and we contend that the Circuit Court of Appeals followed them. We contend also that,

in the light of these tests, there was no warrant in law and no substantial basis in the evidence to justify the Tax Court's decision.

Other equally applicable and equally well settled rules of law might well be summarized, viz.: there is "nothing unlawful or even mildly unethical in the motive of a taxpayer to avoid some portion of the burden of taxation by making a gift of income producing property to his wife (*Marshall v. Comm.*, 57 Fed. 2d 633); *Barach v. Comm.*, 90 Fed (2d) 323; where an interest is acquired in the *partnership capital*, the share of profits belonging to the owner of that capital interest is directly taxable to such owner (*Humphreys v. Comm.* 88 Fed (2d) 430; *Comm. v. Olds*, 60 Fed. (2d) 252); a husband and wife are separate taxpayers and a husband may not be taxed with his wife's income (*Hoeper v. Wisconsin*, 284 U. S. 206); a husband may form a valid partnership with his wife making each partner taxable only for his or her distributive share of the profits (*Comm. v. Olds*, 60 Fed. (2d) 252); this is true of a limited partnership with the wife a limited partner (*Glensder Textile Co.* 46 B. T. A. 176 — Acquiescence by Com'r. Cum. Bul. 1942—1 p. 8); even in a general partnership the management may be lodged in one or more of the partners to the exclusion of others (*Comm. v. Olds*, 60 Fed. (2d) 252); it is of no importance how the wife may have used the income which flowed to her from her own property, for income is taxed with regard to the manner of its receipt and against the owner of the income producing *res*, and not with regard to the manner of expenditure (*Marshall v. Comm.*, 57 Fed. (2d) 634); and even if the sole intent of the parties is to minimize taxes, it does not affect a transaction entered into in good faith and legally consummated (*Gregory v. Helvering*, 293 U. S. 465, 469; *Bullen v. Wisconsin*, 240 U. S. 625, 630; *Superior Oil Co. v. Mississippi*, 280 U. S. 390, 395).

THE ONLY QUESTION BEFORE THIS COURT

A comparison of the Commissioner's Petition for Certiorari and his brief in the instant case might almost lead

one to the conclusion that the granting of the Writ caused the reasons for its application to vanish.

In his Petition for Certiorari the Commissioner alleges that the decision of the Circuit Court of Appeals in the instant case is in direct conflict, or inconsistent, with nine cases in other circuits, viz.: *Earp v. Jones*, 131 Fed. (2d) 292; *Mead v. Comm.*, 131 Fed. (2d) 323; *Waldburger v. Helvering*, 131 Fed. (2d) 598; *Tinkoff v. Comm.*, 120 Fed. (2d) 564; *Doll v. Comm.*, 149 Fed. (2d) 239; *Argo v. Comm.*, 150 Fed. (2d) 167; *Grant v. Comm.*, 150 Fed. (2d) 915; *Strong v. Comm.* 150 Fed. (2d) 915, and *Lusthaus v. Comm.* 149 Fed. (2d) 232. The Commissioner's present brief in the instant case now does not even mention the Earp, Argo, Strong, Waldburger and Tinkoff cases, and cites the Mead, Doll and Grant cases without indicating any definite reason therefor (B. 17). The Lusthaus case, set for argument with the instant case, will be discussed later.

The Commissioner, in his Petition for Certiorari, also alleges that the "question presented in the instant case is an important one in the administration of the tax law" (B. 18) and states that a "decision of this Court in the instant case will serve as a basis for resolving pending, as well as future cases and alleviate the administration and judicial burden which the widespread creation of family partnerships is causing" (Pet. for Writ, p. 19). We now find nothing in Petitioner's brief pertaining to this broad claim on the basis of which he sought from this Court a Writ of Certiorari.

We opposed the granting of the Writ. We contended and we contend now, that the instant case depends on its own facts — *it is not controlled by, and it does not control, the Lusthaus case, or any other family partnership case.*

In the instant case, the Tax Court made Findings of Fact on which we relied in the Circuit Court of Appeals, and on which we rely in this Court. There was no evidence which contradicts those Findings. It is our contention that on the basis of these Findings, the Tax Court's decision was erroneous, as a matter of law, and the de-

cisions of the Circuit Court of Appeals was correct and should be affirmed.

We rest our contention squarely on the law recently laid down by this Court in *Dobson v. Comm.*, 320 U. S. 489; and *Comm. v. Scottish Am. Co.*, 323 U. S. 119; it being our claim that "there was no warrant in the record" and there was not "substantial basis in the evidence" to justify the Tax Court's conclusion. What was said by this Court in *Bingham Trust v. Comm.*, June 4, 1945, Sup. Ct. Adv. Op. Vol. 89, No. 16, p. 1191, is also pertinent as bearing on our claim that in the instant case the Circuit Court of Appeals properly reversed the Tax Court for its error of law in arriving at conclusions having no substantial basis in the evidence.

THE TAX COURT'S DECISION

The Tax Court stated in its opinion that:

> "petitioner did not intend to make a gift of the stock, he did not intend to divest himself of such title, dominion and control of the stock as was necessary to constitute a good and valid gift thereof in praesenti, the transfer was not such that the entire dominion and control of the gift was in the wife" (T. 16), and the husband was "the person who earned the income which was credited to the wife's account" (T. 20).

We challenged government counsel in the Circuit Court of Appeals to find anything in the testimony, anywhere, (or in the Tax Court's Findings of Fact) which bears out this statement of Judge Harron of the Tax Court. It is significant that her decision was not reviewed by the other members of the Tax Court.

Counsel did not meet, and made no attempt to meet, this challenge, though we made it in our briefs and on the oral argument before the Circuit Court of Appeals. When counsel failed to meet the challenge, we challenged the Circuit Court of Appeals to find anything in the record, anywhere, which would bear out Judge Harron's state-

ment or from which an inference could be drawn that there was any "warrant in law" or "substantial basis in the evidence" to support the Tax Court. It will be noted that Judge Martin, in his dissenting opinion in the instant case (T. 65) did not meet, and did not attempt to meet, this challenge.

While we fully realize that a right decision, even though based on a wrong reason, should not be reversed, it is nevertheless significant that in the instant case the reasoning of Judge Harron of the Tax Court, based largely on false premises, is not sound. The opinion of the Circuit Court of Appeals shows that the decision of the Tax Court is not sound, and petitioner's present brief shows that the Solicitor General himself has no faith in some of the Tax Court's conclusions, on which conclusions the Tax Court based its decision.

The Tax Court came to certain legal conclusions which formed the basis of its opinion. We shall discuss each of them briefly, but before doing so we call this Court's attention to the fact that the instant case involves a gift and a partnership organized under the Uniform Limited Partnership Act (set forth in part in appendix to this brief).

This Court, in the Dobson case, has referred to decisions of the Tax Court as being "characterized by substantial uniformity", and as being entitled to great weight and not subject to review if they have "warrant in the record" and "a reasonable basis in law". This Court has also said in a concurring opinion in the more recent Bingham's Trust case that while "the interpretation of tax statutes and their application to particular circumstances are all matters peculiarly within the competence of the Tax Court, on the other hand, constitutional adjudication, determination of local law questions and common law rules of property such as the meaning of a general power of appointment, or the application of the rule against perpetuities, are outside the special province of the Tax Court."

There might well have been included in the latter category questions of what constitutes a gift, a limited part-

nership, or what constitutes the beneficial use, as distinguished from the ownership, of the legal title to real or personal property. These, too, involve common law rules of property, and they involve no "interpretation of tax statutes."

(1) The Tax Court held that the taxpayer did not *intend* to make a gift of the stock or divest himself of such title and control as was necessary to constitute a good and valid gift *in praesenti* (T. 16); that there was no unconditional gift of the stock to the wife, since she could only use it in one way, namely, to place the corporate assets which the stock represented into the partnership (T. 17). The Circuit Court of Appeals effectively answered this point by saying that

> "the conclusion that the transfer was invalid as a gift is rested on the ground that title, dominion and control of the subject matter were not, *in praesenti*, conveyed * * *. A gift is not invalid because of conditions imposed on the donor which are not inconsistent with the immediate vesting of legal title in the donee * * *. Granted, however, that because of the condition, Tower's gift was not complete at the time he gave the shares to his wife, the condition was almost immediately performed. The gift was then both valid and complete, vesting title in the wife to the corporation assets contributed by her to the partnership capital" (T. 62).

(See also, as to the requisites of a valid gift, *Edson v. Lucas*, 40 Fed. (2d) 398).

We might also add that the effect of the Tax Board's conclusion on this point is that the gift was not the stock of the predecessor corporation, but was an interest in the successor partnership. Surely a gift of an interest in the partnership, after its organization, would be no less effective than a gift of the corporate stock because, after all, the test is whether there was a gift of property or capital as distinguished from a gift of profits or personal earnings. The Petitioner does not now claim in his brief that the gift was not *in praesenti* and was conditional. Ap-

parently he has lost faith in this point, which was so vigorously used by the Tax Court in holding against the taxpayer.

(2) The Tax Court held that the taxpayer did not "intend" to make a gift. The Petitioner no longer urges this point, which at all times was purely argumentative and not judicial. A man's intent is usually gathered or inferred from his actions which, it has been said, speak louder than words. His mere statement or claim that he intends to make, that he was making, or that he had made, a gift, would receive very little consideration from this or any other court. In the Circuit Court of Appeals we asked the question, which no one attempted to answer, "what could the taxpayer have done that he did not do to make a bona fide gift!"

(3) The Tax Court concluded that the taxpayer "never intended his wife to have the 190 shares of stock to do with as she pleased * * * upon the dissolution of the corporation, she was not free to sell or otherwise dispose of her share of the corporate assets * * * as a matter of fact, she never received her proportional share of the assets, but they were all transferred, directly to the corporation" (T. 17).

The Petitioner has also abandoned this rather foolish conclusion. Of course, the wife never received her proportionate share of the corporate assets and of course they were all transferred directly to the partnership. The assets of the corporation, by agreement of all the parties and as fully set forth in the partnership agreement (Appendix B, Petitioner's Brief) and partnership certificate (Appendix this brief) were all transferred to the partnership. Even if it had been practicable to do so, what a useless thing it would have been to divide the assets among the three parties in accordance with their ownership of stock, and then have the three parties convey their respective shares of such assets to the partnership.

(4) The Tax Court concluded that because "the gift of the corporate stock was not valid and complete, it follows that the wife made no capital contribution to the partnership, and since she admittedly rendered no services, it

must be held that she was not a bona fide partner" (T. 18). As already indicated, the gift of the stock was complete, and Petitioner now makes no claim to the contrary, except as he claims that the husband did not lose the economic benefit of that which he gave away, which question will be hereinafter discussed.

(5) The Tax Court concluded (in its opinion, not in its Findings of Fact) that the taxpayer "was the person who earned the income which was credited to the wife's account" (T. 20). This conclusion was apparently thought by the Tax Court to be necessary to sustain its decision by bringing this case within the well recognized rule that a man cannot make future returns of income *from personal services* taxable to his wife or to any other than the real earner of such income, viz., the husband. (*Lucas v. Earl*, 281 U. S. 111; *Burnet v. Leininger*, 285 U. S. 136). The Tax Court tried to bring the instant case within the rule of these cases by stating that after the dissolution of the corporation and the organization of the partnership, the business was conducted precisely as it had been before with Francis E. Tower, as the general manager, rendering the same services after as before the change. The Tax Court, in its opinion, politely ignored the facts which the Tax Court found (T. 11) with reference to the character of the business, viz., that it regularly employed from 40 to 60 people in its operations; that it owned assets used in the business having a value of approximately $200,000.00; that the business is comprised of a manufacturing plant containing 30,000 square feet of floor space and producing sawmill machinery and metal stampings for the refrigerator trade (T. 16). That capital was an essential and major income producing factor in the business cannot be questioned.

Petitioner asks for a reversal on the basis of the same conclusion, saying that the "profits were in a large measure the result of his (taxpayer) personal services" (B. 15). There is no Finding of Fact to this effect, there is no evidence to this effect, and all the facts showing the nature of the business are directly to the contrary.

(6) The Tax Court concluded that the wife made no contribution to the partnership, because "the gift of the corporate stock was not valid and complete (T. 18) and as she rendered no personal services she was not a bona fide partner" (T. 18). As already indicated, the gift of the corporate stock was valid and complete, and being valid and complete, the wife contributed (as the result of her original ownership of the 5 shares and her acquisition in 1938 of the 190 shares) $62,400.00 of capital as against the taxpayer's contribution of $81,600.00 and Amidon't contribution of $16,000. (See Certificate of Partnership, Appendix this brief).

Insofar as the rendition of services by the wife is concerned, attention is called to Section 20.54 (See Appendix) of the Michigan Uniform Limited Partnership Law, which expressly provides that:

> "The contribution of a limited partner may be cash or other property *but not services.*"

(7) The Tax Court concluded that the attempt to make a gift was not successful because the husband never really divested himself of "title, dominion and control of the subject of the gift" (T. 16). The Petitioner contends that the taxpayer did not part with the economic benefits of that which he attempted to give away, saying that "it is inconceivable that he considered himself any poorer after the making of the partnership arrangement" (B. 17).

That the parties complied with all legal requirements in making a gift, in organizing a partnership, in conducting a partnership, and in crediting and distributing the profits to the partners in accordance with the partnership agreement and their capital interests cannot be seriously questioned.

What is now urged to justify the conclusion of the Tax Court that the taxpayer did not part with the economic benefits of that which he attempted to give away? What "warrant is there in the record" (*Dobson v. Comm.* supra, *Bingham's Trust v. Comm.*, supra); or "where is there substantial basis in the evidence" (*Comm. v. Scottish Co.*,

supra) for a conclusion that the taxpayer did retain the economic benefits?

The Tax Court, in its opinion, states that as the result of arrangements made about four months *after* the partnership was organized, the husband and Amidon stopped drawing salaries after the first year of the partnership (T. 19) under an agreement whereby Amidon (not related to the family) because of increased duties, was given a 10% increase in his share of the profits, taxpayer and his wife each surrendering 5% of their share to Amidon (T. 20); that after the partnership was formed, the taxpayer still continued to control and actively direct its affairs (T. 18); that for all practical purposes the business was petitioner's business before and after the partnership was organized (T. 19); and that while the wife's shares of the profits were all duly credited to her and she withdrew very substantial portions of them (comparable to her husband's and Amidon's withdrawals), she expended portions of her withdrawals for household and other family purposes.

The Petitioner makes the same general claims and also contends that the control of the partnership having been vested in the taxpayer by virtue of his majority-capital contribution, the taxpayer controlled all of the economic benefits (B. 14, 15). We shall dispose of these points in their order:

(1) During the first year of the partnership the taxpayer, and Amidon, who actively managed the business, drew salaries which were deducted before profits were determined. The agreement later made that, in view of the percentage of profit changes, they would draw no salaries was made not for the benefit of the taxpayer or his wife — it was made in order to satisfy Amidon whose responsibilities and duties were increased as a result of an increase in the volume of business (T. 13). If, as the result of his arrangement, the taxpayer received less than before, then Amidon also received less and it was the wife who received more. If as the result of this arrangement the taxpayer and Amidan received more, the wife would receive less. In either event, it can hardly be claimed that an arrangement made to give Amidon, a stranger to the family, a larger share of the

profits, was made to divert the taxpayer's income to his wife. Even if the result of the taxpayer and Amidon receiving no salary constituted indirectly a diversion of *some* of taxpayer's income to his wife, the Commissioner of internal Revenue was in position to claim that under the tax laws, salaries must be paid to the general partners, and deducted from earnings before such earnings are allocated to all the partners on the basis of their contributions of capital. He never made any such claim and raised no such issue, and it is rather late in the day now, six years later, to make such a claim in an effort to sustain his contention that the taxpayer should be taxed on the entire income.

(2) The taxpayer did continue to control and direct the business of the partnership as he had controlled and directed the business of the corporation. He did this because he held more than a 51% interest of the general partners. He would have had the same control in a corporation (and did in the former corporation) and he would have had the same control in the partnership had his wife's interest as a limited partner been held by a stranger to the family. After all, the test should be whether his legal or equitable rights were any different, insofar as the interest he had given to his wife are concerned, than they would have been if her interest had been held by a stranger.

The control of the partnership exercised by the taxpayer was the control required by the Uniform Limited Partnership Act, which expressly provides that "the contributions of a limited partner may be cash or other property but not services," and which penalizes a limited partner if "he takes part in the control of the business" by making him liable to creditors in the same way as a general partner (Secs. 20.54 and 20.57, Limited Partnership Act — See Appendix). The general partners are entrusted with the management of the business and the limited partner is forbidden to render services or take part in the management of the business.

The trial judge seemed to have the impression that the lawyers and accountants in Michigan were engaged in a conspiracy to defraud the government because they had

advised some of their clients that it would be to their advantage, in the way of lower state and federal taxes, less bookkeeping, and the preparation of fewer reports, to dissolve small corporations and organize limited partnership under the Michigan law.

The Michigan law provides that a group of individuals may do business under various legal entities, viz., (a) as a Corporation (*Mich. Stats. Ann.*, Sec. 21.1 et seq.), (b) as a Partnership Association Limited having the characteristics of a corporation and being so treated by both state and federal tax laws (Sec. 20.91), (c) as a General Partnership (Sec. 20.1) or (d), as a Limited Partnership (Sec. 20.52). That the limited partnership involved in the case at bar is not merely a clever invention of lawyers and accountants is demonstrated by the fact that the Michigan Limited Partnership law in effect in Michigan since 1846, in substantially the present form, is the Uniform Limited Partnership Act now in effect in the same or in modified form in all the states except Louisiana.

Under the agreement of partnership in the instant case, a limited partner has the right to sell his or her interest (Pet. Br. Appendix B, p. 24) the price, in case of dispute, to be fixed by three appraisers, one chosen by the *retiring partner*, one by the *remaining partner*, and the third by the two so selected (Pet. Br. p. 24). In case of dispute between the partners, the dispute, under the agreement, must be referred to arbitration of three disinterested persons, one to be chosen by each party to the dispute, and the third by the two so chosen (Par. 10, Partnership Agreement p. 27 Petitioner's brief).

It will be noted that the husband's control of the partnership was not as broad as was his former control of the corporation because under the partnership agreement any dispute would give rise to arbitration instigated by the wife as a limited partner. This would apply if the general partners voted themselves excessive salaries, though even in the absence of these provisions for arbitration the aid of the courts could always be invoked. Regardless, however, of these remedies available to a limited partner, the control by taxpayer of the partnership was

no different than is the control exercised by a majority stockholder in a corporation through his elected board of directors over the payment of salaries and the distribution of dividends.

When taxpayer made the gift, he was the majority stockholder in a corporation. After he made the gift and after the partnership was organized, he was the majority in interest of the general partners and to that extent exercised the same control as before; subject, however, to the rights given to the limited partners by the agreement as herein indicated. Such control, however, was no different than if his wife's interest had been held by a limited partner who was a stranger to the family. This, after all, is the test that should be applied. What rights she could have asserted, if it became necessary to assert them, to obtain what was due her, should be the criterion in determining whether or not the husband parted with the dominion, control and economic benefit of that which he attempted to give away.

The power to manage is not synonymous with the right to the economic benefits flowing from the property being managed.

Some of the wife's income from the partnership was used by her to build and furnish a cottage, her husband furnishing the balance of the funds. Together they bought war bonds, each contributing one-half of the purchase price. She paid for some of her own clothes, and saved portions of her withdrawals from the partnership, keeping the funds in a safe to which both had access but in which each had a separate box. Taxpayer continued to pay general household bills, as before (T. 14).

The wife at all times had credited to her all, and withdrew from time to time, substantial portions of her share of the profits. She never, at any time, relinquished the interest which had been turned over to her, and her husband at no time exercised any control or supervision over, or any beneficial ownership in, her share of the partnership business or profits. Her partnership interest was assignable, as already pointed out, and it was free from domination or control of her husband. He had

parted with the record title as the result of his prior gift of the stock, and as the result of filing the Certificate of Limited partnership in the office of the County clerk of Montcalm County (Appendix, this brief).

The taxpayer legally did not own, and he could not sell, assign or encumber the interest in the partnership owned by his wife. She *could* sell that interest without his consent, and she could resort to arbitration and to the courts to protect that interest from being diverted or dissipated by him. In case of her death, it went to her heirs or legatees free from his domination and control.

Petitioner claims that "on the record here it is inconceivable that the respondent could have considered himself any poorer after the making of the partnership arrangement" (B. 17).

The taxpayer and his wife were no doubt happily married and had no domestic difficulties, financial or otherwise. Taxpayer may have felt, as most happily married husbands and wives feel, that, in case of need, anything and everything she had she would cheerfully turn over to him. But surely this is not the test to be here applied where we are considering legal rights. Tax laws surely do not penalize husbands and wives who get along well together and who would sacrifice for each other all they possessed in case of need, as against those who, in financial matters, treat each other as strangers.

We contend that the parties here did what they had a legal right to do. They did it in good faith. And they carried out their arrangement in good faith. No one has yet been able to point to anything in the record in this case from which a contrary inference can be drawn.

Surely counsel do not ask this Court to establish a new principle of law and one contrary to the present Revenue Laws which permit (and under the gift and estate tax laws encourage) husbands to make gifts to their wives, which permit husbands and wives to file separate returns, and which permit persons, including husband and wives, to carry on business under various legal entities, including limited partnerships, general partnerships, cor-

porations, and unincorporated associations. And, surely Counsel do not ask this Court to hold that in any case involving a gift from a husband to a wife, or involving a partnership in which a husband and wife are members, the Tax Court can, regardless of the facts, preclude a review by an appellate court under Sec. 240 of the Judicial Code, as amended, (Title 26 Par. 1141—3c, Federal Code Annotated) merely by making a final finding, not based on evidence, that the gift was not bona fide and complete, that the husband retained the economic benefits of that gift, that a partnership was not bona fide, or that the husband — and not capital — earned the income.

It is only on such theories that the decision in the instant case is subject to reversal — theories which have already been expressly repudiated by this Court in the recent case of Bingham's Trust v. Comm. (June 4, 1945) supra, in which this Court said:

> "Hence the statute does not leave the Tax Court as the final arbiter of the issue whether its own decisions of questions of law are right or wrong. That can only be ascertained upon resort to the prescribed appellate process by a consideration of the merits of the point of law involved, and by its decision at the conclusion of the process, not before it begins. The fact that the Court of Appeals below, while accepting the Tax Court's findings of fact, has nevertheless reversed its decision, would seem not to leave the question of law decided so free from doubt that the mandate of the statute could rightly be disregarded on any theory. If review were to be denied in this case, it would be difficult to say that any construction of a taxing statute by the Tax Court would be subject to appellate review."

THE LUSTHAUS CASE

If the Lusthaus case was correctly decided by the Tax Court and the Circuit Court of Appeals for the Third Circuit, it is still not controlling in the instant case. The facts are in no way similar, and the following points in the Lusthaus case might well afford a basis for the claim

that there was "warrant in the record" and "substantial basis in the evidence" to support the Tax Court's decision that the gift and partnership were a sham.

1. The partnership agreement provided that "under no circumstances shall one of the partners sell • • • pledge or encumber • • • his or her interest in the partnership without the written consent of the other" (Lusthaus Transcript 50). The wife therefore acquired from the husband nothing she could sell, thereby not acquiring the usual and essential benefits incident to ownership.

2. The partnership agreement and bill of sale transferring a share of the assets to the wife were signed and delivered June 4, 1940, after five months' profits had been earned (Lusthaus Transcript 48), yet the parties tried to make it retroactive to Jan. 1, 1940, under the claim that they had orally agreed to the transaction prior to that time (Lusthaus Transcript 4). The certificate required by law was actually not filed with the State of Pennsylvania until July 31, 1940 (Resp. Brief Lusthaus p. 4). The parties therefore attempted, among other things, to transfer to the wife 5 months' earnings of the business already accrued and taxable to the husband, earnings which resulted from assets to which the wife did not acquire legal title until after June 5, 1940.

3. The facts in the Lusthaus case were not undisputed. The husband and wife claimed on direct examination that after the formation of the partnership they each drew $50.00 a week and other withdrawals were "divided equally — each getting half" (Lusthaus Transcript 7). The records of the company (produced after the husband's cross-examination in which he again stated that withdrawals were to be in equal portions) showed that in 1940 (the tax year in question) the husband withdrew $4,604.76, and the wife withdrew $59.61 (Lusthaus Transcript 59).

4. While the wife gave eleven notes for $5,000.00 each for part of the purchase price, the notes being payable annually beginning Jan. 1, 1941, she was to pay them "from the profits of the business" (Lusthaus Transcript 15). What was set up as a purchase for a consideration

of $55,000.00, was therefore, in reality, not a purchase at all because she was never expected to pay anything out of her own pocket.

5. In 1941 the husband withdrew $19,198.69 (Lusthaus Transcript 59, 60). The wife's share was $31,871.97, but she withdrew only $16,317.96, all of which went to pay her two notes to Mr. Lusthaus (Lusthaus Transcript 27) and to pay income taxes on her distributive share (Lusthaus Transcript 27). It will be seen that the wife, while claiming to buy an interest in the business for $55,000 (Lusthaus Transcript 39) paid in nothing out of her own pocket and during the first two years of the partnership (only years covered by testimony), she took out nothing. She derived no economic benefit from either her husband's gift or her purchase made with money given her by her husband.

6. The social security tax returns filed by the business in 1939 showed the husband as the sole owner. The returns for 1940 and for the first three months of 1941 still showed the husband as sole owner. Only later returns showed the claimed partnership.

7. The husband claimed on the witness stand that after the partnership was organized, a bank account was opened in the partnership name and both he and his wife signed checks on the partnership account (Lusthaus Transcript 18). On further questioning, he had to admit that it was not until some time in 1943 (three years after the partnership was created) that he gave the bank the right to accept her as a partner and the right to draw checks upon the partnership account (Lusthaus Transcript 19).

THE LORENZ CASE

The petitioner cites *Lorenz v. Commissioner*, 148 Fed. (2d) 527. He claims that because that case was decided adversely to the taxpayer by Judges Martin, Allen and Hamilton of the Sixth Circuit, while the Tower case was decided in favor of the taxpayer by Judges Simon and McAllister with Judge Martin dissenting, it follows that only two out of five judges of the Sixth Circuit sustain our claims in the instant case.

Counsel must be hard pressed to get away from the sound reasoning of the Circuit Court of Appeals in the instant caes if he has to rely on such a mathematical formula. And, in view of the totally different facts in the Lorenz case, there can be no possible application of even the formula.

In the Lorenz case, the Tax Court's Findings of Fact showed (a) that there was no written instrument or gift or assignment of an interest in the business to the wife; (b) the claimed partnership agreement was not filed in any public office; (c) the wife was not, while the husband was, given a drawing account on the partnership books; (d) during the tax year involved, the wife withdrew nothing while the husband withdrew $9,381.11; (e) none of the profit was distributed to the wife, all withdrawals being made by the husband and deposited in his own bank account; and (f) the business was in the main a personal service business employing a nominal capital, it being a machinery sales agency having three salesmen with the husband as the principal salesman (3 *Tax Court* 746).

CONCLUSION

We respectfully submit that the decision of the Circuit Court of Appeals should be affirmed. There is no warrant in the record and there is no evidence in the record to sustain the decision of the Tax Court. Petitioner has been unable to point out — and he does not point out — anything in the record indicating that the parties in the instant case did not, in good faith, do what they had a legal and moral right to do; and that they did not carry out fully and honestly their agreement of copartnership with a proper division of the profits to the persons entitled thereto. This Court should not deny to the taxpayer the right which the statute gives him to have his case reviewed by the Circuit Court of Appeals, and to have the latter Court reverse the decision of the Tax Court if there is no warrant and no evidence in the record to support the Tax Court's decision.

The Petitioner, in effect, asks this Court to hold that the decision of the Tax Court is right because it is the de-

cision of the Tax Court; that because the parties entered into an agreement which reduces their taxes, that arrangement must be held fraudulent; and that a partnership between a husband and wife is a sham and must be ignored for tax purposes.

The petitioner, in effect, asks this Court to hold that every assignment of income-producing property from a husband to his wife or from a father to his children should be disregarded as an anticipatory arrangement to shift income within the family group. This goes much farther than the established principle that transactions between members of the family should be carefully scrutinized to determine whether they are genuine. It, in effect, nullifies all gifts between family members by regarding the family as a unit and by regarding transfers within the family as ineffective. It attempts to establish by judicial action the result which Congress refused to enact by statute — that is, to regard the husband and wife as a single tax unit.

We respectfully submit that the instant case is governed by the following well known and well settled principles of law which this Court must either recognize or reject, viz.:

(1) Under all Revenue Acts from the beginning, the husband and wife have been regarded as separate taxpayers and a husband may not be taxed with his wife's income. Although transactions between husband and wife may be carefully scrutinized, in the absence of any showing of irregularity, there are no separate rules of law which are applicable to husband and wife as distinguished from other taxpayers.

(2) A husband may make gifts of property to his wife and thereafter he is not taxable on the fruits and profits from the property transferred. Such property may include shares of stock and transfer of the stock of record is prima facie proof that the stock has been transferred.

(3) A husband and wife who are stockholders in a corporation may elect to change the form of business organization, dissolve the corporation, and form a partnership. The fact that taxes may be saved by such a reorganization does not cause it to be an invalid device.

(4) The partnership may be a limited partnership to which the wife contributes no services provided capital is an important income producing factor. The wife may delegate the management of the partnership to the other partner, and in a limited partnership, the management must be delegated to the general partners.

(5) It is of little importance for tax purposes how the wife may use the income which flows to her from her own property, for income is taxed against the owner of the income producing *res* and not with regard to the manner of its expenditure.

Respectfully submitted,

OSCAR E. WAER,
Attorney for Taxpayer and Respondent.

Applicable Provisions of Michigan Uniform Limited Partnership Act (Act 110 Public Acts of 1931, Chap. 192 — Sections 20.51-20.81, Mich. Stats. Ann., superseding Revised Stats. 1846, Chap. 33).

Sec. 20.54. The contributions of a limited partner may be cash or other property, but not services.

Sec. 20.57. A limited partner shall not become liable as a general partner unless, in addition to the exercise of rights and powers as a limited partner, he takes part in the control of the business.

Sec. 20.59. A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partner, a general partner or all of the general partners have no authority to (a) do any act in contravention of the certificate, (b) do any act which would make it impossible to carry on the ordinary business of the partnership • • • (d),possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose.

Sec. 20.60 (1) A limited partner shall have the same rights as a general partner to (a) have the partnership books kept at the principal place of business of the partnership, and at all times to inspect and copy any of them (b) have on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable, and (c) have dissolution and winding up by decree of court.

(2) A limited partner shall have the right to receive a share of the profits or other compensation by way of income, and to the return of his contribution as provided in sections fifteen (15) and sixteen (16).

Sec. 20.66. Subject to the provisions of paragraph (1) a limited partner may rightfully demand the return of his contribution (a) on the dissolution of the partnership or (b) when the date specified in the certificate for its re-

turn has arrived * * * A limited partner may have the partnership dissolved and its affairs wound up when he rightfully but unsuccessfully demands the return of his contribution, or the other liabilities of the partnership have not been paid, or the partnership property is insufficient for their payment as required by paragraph (1a) and the limited partner would otherwise be entitled to the return of his contribution.

Sec. 20.70. The retirement, death, or insanity of a general partner dissolves the partnership unless the business is continued by the remaining general partners under a right so to do stated in the certificate or with the consent of all members.

Sec. 20.71. On the death of a limited partner his executor or administrator shall have all the rights of a limited partner for the purpose of settling his estate, and such power as the deceased had to constitute his assignee a substituted limited partner. The estate of a deceased limited partner shall be liable for all his liabilities as a limited partner.

APPENDIX

LIMITED PARTNERSHIP CERTIFICATE OF R. J. TOWER IRON WORKS
(Filed Aug. 31, 1937)

Pursuant to the provisions of Act No. 110 of the Public Acts for the State of Michigan for 1931, the undersigned hereby form a limited partnership as follows:

ARTICLE I

The name of the partnership is R. J. TOWER IRON WORKS.

ARTICLE II

The character of the business to be conducted is that of a general foundry and machine shop, the manufacturing and selling of sawmill machinery, road machinery, stampings of steel and articles composed of metal and wood, or metal or wood alone, and any business incidental thereto.

ARTICLE III

The location of the principal place of business is the City of Greenville, in Montcalm County, Michigan.

ARTICLE IV

The names and places of residence of the partners, and the classification thereof, as as follows:

Francis E. Tower, General Partner, Greenville, Michigan.

Harvey A. Amidon, General Partner, Greenville, Michigan.

Hazel I. Tower, Limited Partner, Greenville, Michigan.

ARTICLE V

The partnership shall exist for the term of twenty years unless sooner terminated, as it may be, by a decision of a majority in interest and ownership of the total partner-

ship capital, including the capital interest of the limited partner and the assigns of such limited partner.

ARTICLE VI

The contributions of the several partners to the partnership capital are determined as follows:

All of the plant and equipment, and all of the inventories and property of every kind and nature heretofore belonging to and comprising a part of the business of the corporation known as the R. J. Tower Iron Works, which corporation's term of existence expired on August 30, 1937, are being taken over by this partnership subject to all of the existing indebtedness of said corporation. It is agreed that the net assets of the said R. J. Tower Iron Works, a Michigan corporation, at the time of the dissolution, at a fair value, totaled the sum of $160,000; that such sum is the contribution of the partners to the capital of the partnership; that the agreed value of such capital and property contributed by Hazel I. Tower as a limited partner is the sum of $62,400; that the agreed value of such capital and property contributed by Francis E. Tower as a general partner is the sum of $81,600; that the agreed value of such capital and property contributed by Harvey A. Amidon as a general partner is the sum of $16,000.

ARTICLE VII

Each of the partners shall receive, by reason of his or her contribution, such share of the profits of the partnership business, and bear such share of the losses of the partnership as his or her aforesaid contribution to the partnership capital bears to the total of the partnership capital, and the interest and share of each partner, both general and limited, in the partnership capital shall at all time be the same proportionate share thereof, whether the partnership capital hereafter increases or diminishes in amount or value as a result of business operations. It is intended and agreed, however, that the general partners shall receive salaries from the partnership for the services rendered by them in the active management of the business

of the partnership, and that such salaries shal be deducted from the earnings of the partnership before determining the profits to be distributed to all of the partners. The limited partner shall in no event be liable for or subject to any loss or losses whatsoever in excess of the amount of the capital contributed by her to the capital of the partnership.

ARTICLE VIII

The partnership shall not be dissolved by the death, retirement or incapacity to act of any general partner, or by the sale or transfer of his interest therein; but in any such event the remaining general partner or partners shall continue the business.

ARTICLE IX

The general partners may, at any time by unanimous agreement, admit additional limited partners upon such terms, not more favorable than or accorded the present limited partner, as they may determine and agree upon.

ARTICLE X

The general partners may at any time admit additional general partners by unanimous agreement, upon such terms as will in no manner prejudice or be detrimental to the rights and interest of the limited partner or partners, and any limited partner may become a general partner with the consent of all the general partners.

Francis E. Tower.
Harvey A. Amidon.
Hazel I. Tower.

STATE OF MICHIGAN,
ss.
COUNTY OF KENT.

On August 28, 1937, Francis E. Tower, Harvey A. Amidon and Hazel I. Tower being first duly sworn did each

depose and say that he has read the foregoing certificate of limited co-partnership subscribed by him, that he knows the contents thereof and that the same are true, and each severally acknowledged the same to be his free act and deed for the purposes therein stated.

Oscar E. Waer,
Notary Public, Kent County, Mich.

My commission expires Dec. 13, 1938.

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SUPREME COURT OF THE UNITED STATES.

No. 317.—October Term, 1945.

Commissioner of Internal Revenue, Petitioner, vs. Francis E. Tower.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[February 25, 1946.]

Mr. Justice Black delivered the opinion of the Court.

The Commissioner of Internal Revenue determined that respondent's wife had in her income tax returns for 1940 and 1941 reported as her earnings, income that actually had been earned by her husband but had not been reported in his returns. A deficiency assessment was consequently levied against the respondent by the Commissioner. The particular earnings involved were a portion of net income attributed to a partnership, to which, according to its records, 90 per cent of the capital had been contributed by respondent and his wife, of this, 51 per cent had been contributed by the respondent and 39 per cent by his wife. If as respondent asserts, the circumstances surrounding the formation and operation of this partnership were such as to bring it within the meaning of Sections 181 and 182 of Title 26 of the United States Code, then the respondent and his wife are liable only for their respective individual share of the business' income. These sections provide that partners are liable for taxes on partnership income only in their "individual capacity" and that each partner shall report "his distributive share of the ordinary net income . . . of the partnership." But Section 11 of Title 26 of the United States Code levies a tax on the "net income of every individual", and the "net income" is required to be computed on the basis of "gross income" as defined in Section 22(a), which broadly includes all earnings of any individual from "any source whatever". And we have held that the dominant purposes of all sections of the revenue laws, including these, is "the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid." *Helvering* v. *Horst*, 311 U. S. 112, 119. The basic question in deciding whether the

Commissioner's deficiency assessment was proper, is: Was the income attributed to the wife as a partner income from a partnership for which she alone was liable in her "individual capacity", as provided by 26 U. S. C. §§ 181 and 182, or did the husband, despite the claimed partnership actually create the right to receive and enjoy the benefit of the income, so as to make it taxable to him under Sections 11 and 22(a)?

The respondent asked the Tax Court to review and redetermine the Commissioner's deficiency assessment, insisting that the income in question was not the respondent's but his wife's share in a partnership. The Commissioner urged in the Tax Court that the wife had contributed neither services nor capital to the partnership and that her alleged membership in the partnership was a sham. Respondent admitted that she had not contributed her services, but contended that she had made a contribution of capital as shown by the amount attributed to her on the partnership books and that she was a bona fide partner. Her alleged contribution consisted of assets which the husband claimed to have given to her three days before the formation of the partnership.

The Tax Court concluded that the respondent had never executed a complete gift of the assets which his wife later purportedly contributed to the partnership; that after the partnership was formed respondent continued to manage and control the business as he had done for many years before; that his economic relation to the portion of the partnership income which was attributed to his wife was such that it continued to be available to be used for the same purposes as before, including ordinary family purposes; that the effect of the whole partnership arrangement, so far as it involved respondent and his wife was a mere reallocation of respondent's business income within the family group; and that the dissolution of the corporation and the subsequent formation of the partnership fulfilled no business purpose other than a reduction of the husband's income tax. The Tax Court concluded that this family partnership income was in fact earned by the husband; that there was no real partnership between petitioner and his wife for purposes of carrying on a business enterprise; that the wife received a portion of the income "only by reason of her marital relationship", and held that the entire income was therefore, taxable to the respondent under 26 U. S. C. § 22(a). 3 T. C. 396. The Circuit Court of Appeals for the Sixth Circuit

reversed. 148 F. 2d 388. The Circuit Court of Appeals for the Third Circuit Court sustained a holding by the Tax Court, based on facts in all material respects similar to the ones in this case, that all the income from a husband-wife partnership was taxable income of the husband under 26 U. S. C. § 22(a). *Lusthaus* v. *Commissioner*, 149 F. 2d 232. Other Circuit Courts of Appeals have also sustained similar holdings by the Tax Court.[1] As is indicated by numerous Tax Court decisions, attempts to escape surtaxes by dividing one earned income into two or more through the device of family partnerships have recently created an acute problem.[2] Because of the various views expressed as to controlling legal principles in the decisions discussing such arrangements, we granted certiorari both in this and the *Lusthaus* case.

A statement of some of the pertinent facts shown by the record and on which the Tax Court based its conclusion will cast some light on the problem. Broadly speaking, these facts follow a general pattern found in many of the "family partnership" cases. The business here involved, R. J. Towers Iron Works, is located in Greenville, Michigan and has manufactured and sold sawmill machinery and wood and metal stampings. Respondent's participation in the business dates back twenty-eight years. He has managed and controlled the company since the death of his father in 1927. During the tax years in question the business had forty to sixty employees on its pay roll. From 1933 to 1937 the business was operated as a corporation. The respondent was the president of the corporation and owned 445 out of the 500 shares outstanding,[3] his wife was vice president and owned five shares, and one Mr. Amidon was the secretary, owning twenty-five shares. These three also constituted the Board of Directors, and while Towers managed the corporate affairs, Amidon acted as bookkeeper. Mrs. Towers performed no business services.

In 1937 substantial profits pointed to increased taxes. Respondent's attorney and his tax accountant advised him that dissolution of the corporation and formation of a partnership with

[1] Earl v. Jones, 131 F. 2d 292 (C. C. A. 10th); Mead v. Commissioner, 131 F. 2d 323 (C. C. A. 5th); Argo v. Commissioner, 150 F. 2d 67 (C. C. A. 5th); Lorenz v. Commissioner, 148 F. 2d 527 (C. C. A. 6th).

[2] See cases collected in Paul, Partnerships in Tax Avoidance, 13 G. W. L. Review, 121.

[3] For about six months immediately following incorporation the respondent owned only 425 shares.

his wife as a principal partner, would result in tax savings and eliminate the necessity of filing various corporate returns. The suggested change was put into effect. August 25, 1937, respondent transferred 190 shares of the corporation's stock to his wife on the condition that she place the corporate assets represented by these shares into the new partnership. Respondent, treating the stock transfer to his wife as a gift valued at $37,000.00, later paid a gift tax of $213.44. Three days after the stock transfer the corporation was liquidated, a limited partnership was formed and a certificate of partnership was duly filed for record as required by Michigan law. According to the books, the value of the donated stock became the wife's contribution to the partnership. The formation of the partnership did not in any way alter the conduct of the business, except that both Amidon and Tower ceased to draw salaries. By an agreement made shortly thereafter, a readjustment was made in the amount of profits each partner was to receive, under which Amidon's share became the equivalent of, if not more than, the amount of the salary he had previously drawn. Under the partnership agreement the respondent continued to have the controlling voice in the business, as to purchases, sales, salaries, the time of distribution of income, and all other essentials. Respondent's wife, as a limited partner, was prohibited from participation in the conduct of the business. So far as appears, the part of her purported share of the partnership business she actually expended was used to buy what a husband usually buys for his wife such as clothes and things for the family or to carry on activities ordinarily of interest to the family as a group.

We are of the opinion that the foregoing facts were sufficient to support the Tax Court's finding that the wife was not a partner in the business.[4] A partnership is generally said to be created when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses.[5] When the existence of an alleged partnership arrangement is chal-

[4] Since the Commissioner had determined that the wife was not really a partner, the burden rested upon the respondent to produce sufficient evidence to convince the Tax Court that the Commissioner's determination was wrong. Welch *v.* Helvering, 290 U. S. 111; Commissioner *v.* Heininger, 320 U. S. 467, 475.

[5] Ward *v.* Thompson, 22 How. 330, 333, 334; Meehan *v.* Valentine, 145 U. S. 611, 618.

lenged by outsiders, the question arises whether the partners really and truly intended to join together for the purpose of carrying on business and sharing in the profits or losses or both. And their intention in this respect is a question of fact, to be determined from testimony disclosed by their "agreement, considered as a whole, and by their conduct in execution of its provisions." *Drennen* v. *London Assurance Company*, 113 U. S. 51, 56; *Cox* v. *Hickman*, 8 H. L. Cas. 268. We see no reason why this general rule should not apply in tax cases where the government challenges the existence of a partnership for tax purposes.[6] Here the Tax Court, acting pursuant to its authority in connection with the enforcement of federal laws, has found from testimony before it that respondent and his wife did not intend to carry on business as a partnership. This finding of fact, since supported by evidence, is final. *Commissioner* v. *Heininger*, 320 U. S. 467, 475; *Dobson* v. *Commissioner*, 320 U. S. 489. The decision of the Tax Court was therefore correct unless, as respondent contends, the Tax Court erroneously disregarded or improperly applied certain legal principles.

Respondent contends that the partnership arrangement here in question would have been valid under Michigan law and argues that the Tax Court should consequently have held it valid for tax purposes also. But the Tax Court in making a final authoritative finding on the question whether this was a real partnership is not governed by how Michigan law might treat the same circumstances for purposes of state law. Thus, Michigan could and might decide that the stock-transfer here was sufficient under state law to pass title to the wife, so that in the event of her death it would pass to whatever members of her family would be entitled to receive it under Michigan's law of descent and distribution. But Michigan cannot by its decisions and laws governing questions over which it has final say, also decide issues of federal tax law and thus hamper the effective enforcement of a valid federal tax levied against earned income. The contention was rejected in *Lucas* v. *Earl*, 281 U. S. 111. There husband and wife made an agreement for joint ownership of the husband's future income. Assuming that the husband's future earnings were under California law considered as

[6] What would be the effect for tax purposes should taxpayers after holding themselves out as a partnership later challenge the existence of the partnership, is a question not here presented. See Higgins *v.* Smith, 308 U. S. 473, 477.

partly owned by the wife, this Court refused to accept the state's concept of the effect of the agreement which would have reduced the federal tax on income actually earned by the husband. And in *Helvering* v. *Clifford*, 309 U. S. 331, 334-335, we held that the purpose of 26 U. S. C. § 22(a) to tax all income against the person who controlled its distribution could not be frustrated by family group arrangements, even though the distribution arrangements were valid for state law purposes. The statutes of Congress designed to tax income actually earned because of the capital and efforts of each individual member of a joint enterprise are not to be frustrated by state laws which for state purposes prescribe the relations of the members to each other and to outsiders. Cf. *Burke-Waggoner Assn.* v. *Hopkins*, 269 U. S. 110, 114.

Respondent contends that the Tax Court's holding that he is taxable for the profits from the partnership is contrary to a principle long recognized by this Court that "The legal right of a taxpayer to decrease the amount of what would otherwise be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." *Gregory* v. *Helvering*, 293 U. S. 465, 469. We do not reject that principle. It would clearly apply, for example, in a situation where a member of a partnership, in order to keep from paying future taxes on partnership profits and in order to get into a lower income tax bracket sells his interest to a stranger relinquishing all control of the business. But the situation is different where the taxpayer draws a paper purporting to sell his partnership interest even to a stranger, though actually he continues to control the business to the extent he had before the "sale" and channels the income to his wife. Then a showing that the arrangement was made for the express purpose of reducing taxes simply lends further support to the inference that the husband still controls the income from his partnership interest, that no partnership really exists and that earnings are really his and are therefore taxable to him and not to his wife. The arrangement we are here considering was of the type where proof of a motive to reduce income taxes simply lent further strength to the inference drawn by the Tax Court that the wife was not really a partner. See Paul, Selected Studies in Federal Taxation, 2d series, pp. 293-300. To rule otherwise would mean ordering the Tax Court to shut its eyes to the realities of tax avoidance schemes.

Respondent urges further that the Tax Court erroneously con-

cluded that the gift was ineffective for tax purposes because it was conditional and therefore incomplete. The government defends the Tax Court's conclusion. We do not find it necessary to decide this issue. The question here is not simply who actually owned a share of the capital attributed to the wife on the partnership books. A person may be taxed on profits earned from property, where he neither owns nor controls it. *Lucas* v. *Earle*, *supra*.[7] The issue is who earned the income and that issue depends on whether this husband and wife really intended to carry on business as a partnership. Those issues cannot be decided simply by looking at a single step in a complicated transaction. To decide who worked for, otherwise created or controlled the income, all steps in the process of earning the profits must be taken into consideration. See *Commissioner* v. *Court Holding Co.*, 324 U. S. 331, 334. Of course, the question of legal ownership of the capital purportedly contributed by a wife will frequently throw light on the broader question of whether an alleged partnership is real or pretended. But here the Tax Court's findings were supported by a sufficient number of other factors in the transaction, so that we need not decide whether its holding as to the completeness of the gift was correct. Cf. *Helvering* v. *Hallock*, 309 U. S. 106, 117, 118; *Burnet* v. *Wells*, 289 U. S. 670, 677.

There can be no question that a wife and a husband may, under certain circumstances, become partners for tax, as for other, purposes. If she either invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of these things she may be a partner as contemplated by 26 U. S. C. §§ 181, 182. The Tax Court has recognized that under such circumstances the income belongs to the wife.[8] A wife may become a general or a limited partner with her husband. But when she does not share in the management and control of the business, contributes no vital additional service, and where the husband purports in some way to have given her a partnership interest, the Tax Court may properly take these circumstances into consid-

[7] Under some circumstances income has been held taxable to a person even when he does not own or control it. United States *v.* Joliet & Chicago R. Co., 315 U. S. 44, 46.

[8] See e. g. Croft *v.* Commissioner, T. C. No. 1432, decided February 9, 1944.

eration in determining whether the partnership is real within the meaning of the federal revenue laws.

It is the command of the taxpayer over the income which is the concern of the tax laws. *Harrison* v. *Schaffner*, 312 U. S. 579, 581, 582. And income earned by one person is taxable as his if given to another for the donor's satisfaction. *Helvering* v. *Horst*, 311 U. S. 112, 119. It is for this reason, among others, that we said in *Helvering* v. *Clifford*, *supra*, 335, that transactions between husband and wife calculated to reduce family taxes should always be subjected to special scrutiny. For if under circumstances such as those now before us, the end result of the creation of a husband-wife partnership, though valid under state laws, is that income produced by the husband's efforts continues to be used for the same business and family purposes as before the partnership, failure to tax it as the husband's income would frustrate the purpose of 26 U. S. C. § 22(a). By the simple expedient of drawing up papers, single tax earnings cannot be divided into two tax units and surtaxes cannot be thus avoided.

Judged by the actual result achieved, the Tax Court was justified in finding that the partnership here brought about no real change in the economic relation of the husband and his wife to the income in question. Before the partnership the husband managed, controlled, and did a good deal of the work involved in running the business, and he had funds at his disposal which he either used in the business or expended for family purposes. The wife did not contribute her services to the business and received money from her husband for her own and family expenses. After the partnership was formed the husband continued to control and manage the business exactly as he had before. The wife again took no part in the management or operation of the business. If it be said that as a limited partner she could not share in the management without becoming a general partner the result is the same. No capital not available for use in the business before was brought into the business as a result of the formation of the partnership. And the wife drew on income which the partnership books attributed to her only for purposes of buying and paying for the type of things she had bought for herself, home and family before the partnership was formed. Consequently the result of the partnership was a mere paper reallocation of income among the family members. The actualites of their relation to the income

did not change. There was, thus, more than ample evidence to support the Tax Court's finding that no genuine union for partnership business purposes was ever intended and that the husband earned the income. Whether the evidence would have supported a different finding by the Tax Court is a question not here presented.

Reversed.

The CHIEF JUSTICE and Mr. Justice REED dissent for the reasons stated in their dissenting opinion in *Lusthaus* v. *Commissioner*, No. 263, decided today.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

SUPREME COURT OF THE UNITED STATES.

No. 317.—October Term, 1945.

Commissioner of Internal Revenue, Petitioner, vs. Frances E. Tower.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[February 25, 1946.]

Mr. Justice Rutledge, concurring.

I agree with the result and with the Court's view that the evidence was amply sufficient to sustain the Tax Court's findings and conclusions in this case and in *Lusthaus* v. *Commissioner*, No. 263. I candor forecasting to add, however, that in my judgment the decisions' effect is to rule that in situations of this character the formation of a limited partnership under state law between husband and wife, with the latter as the limited partner, following immediately upon the husband's donation to the wife of a share in the assets of the business previously and afterwards conducted by him and conditioned upon her leaving the assets in the business does not, as a matter of federal tax law, accomplish the formation of a partnership sufficient to relieve the husband of tax liability for the income derived after the transfer from use in the business of the share thus donated to the wife. In other words, I think that as a matter of law the taxpayers in these cases were liable for the taxes assessed against them, including the deficiency assessments; and, therefore, in my opinion the Tax Court is not free in these or substantially similar circumstances to draw either the contrary conclusion or opposing ones. While it is not strictly necessary to express this opinion in these cases in view of the Tax Court's consistent conclusions of liability, it is inconceivable to me that the two cases, consistently with the federal tax law, could be decided the other way or with different outcomes on the facts presented. Being of this opinion, I consider the failure to state it could only tend to perpetuate a source of possible confusion for the future.